

Unclassified

CCNM/ENV/EAP(2002)1



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

24-Apr-2002

English - Or. English

**CENTRE FOR CO-OPERATION WITH NON-MEMBERS
ENVIRONMENT DIRECTORATE**

CCNM/ENV/EAP(2002)1
Unclassified

**Task Force for the Implementation of the Environmental Action Programme for
Central and Eastern Europe (EAP)**

**STREAMLINING THE USE OF ECONOMIC INSTRUMENTS OF ENVIRONMENTAL POLICY IN
THE ROSTOV OBLAST, RUSSIA
Final Project Report**

Presented at the stakeholder consultation workshop in Rostov-on-Don, Russia, March 13, 2002

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JT00125034

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English - Or. English

DEFRA
Department for
Environment,
Food & Rural Affairs

This project was financed by the grant of the Department for Environment, Food and Rural Affairs (DEFRA) of the United Kingdom.

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ANNEX 1. RULES FOR AWARDING GRANTS, LOAN INTEREST SUBSIDIES AND PROVIDING LOAN GUARANTEES FOR ENVIRONMENTAL PROJECTS FROM THE ROSTOV OBLAST BUDGET [DRAFT]

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1. INTRODUCTION

The scope of this project is based on the priority measures to improve economic instruments of environmental policy in the Rostov Oblast that are identified in the 2001 Regional Environmental Action Plan (REAP) for the oblast: appropriate differentiation of pollution charges and “fees for the use of water resources” (fees for water abstraction and wastewater discharge by volume, referred to further as water fees), improved revenue collection and disbursement, and using a wider range of economic incentives. Pollution charges and water fees constitute the bulk of revenues earmarked by the Oblast Administration for environmental improvement projects.

The project is implemented by a team of experts of the Organization for Economic Cooperation and Development (OECD)¹ under the grant of the Department for Environment, Food and Rural Affairs of the United Kingdom.

The project addresses the objective of streamlining the system of economic instruments in the Rostov Oblast from a policy packages perspective, not only by improving the design of individual instruments (within the parameters set out in Russian federal laws and regulations) and drafting procedures for their application, but strengthening their linkages to such command-and-control instruments as permits, monitoring, and enforcement. The emphasis on working out effective mixes of environmental policy instruments is increasingly practiced in industrialized countries.

Stakeholder involvement is also a critical element of the project. The stakeholder dialogue brought together representatives of the Rostov Oblast Administration, Russian federal government, local authorities, industry, and the NGO community to initiate, discuss, and validate the project’s recommendations.

For the first stakeholder consultation in November 2001, a Background Issue Paper was prepared that outlined the following principal issues with respect to the current practice of using economic instruments of environmental policy in the Rostov oblast:

- Pollution charge and water fee rates,
- Pollution charge and water fee revenue collection,
- Revenue disbursement, and
- Environmental insurance and damage compensation.

Thus, the package of environmental policy instruments covered by the project includes economic instruments (charges, fees, and subsidies), enforcement instruments, and environmental liability-related instruments.

The oblast stakeholders discussed ideas for improvements in the existing system on each of these issues. On the basis of expert analysis and stakeholder inputs, this report presents the project’s recommendations and specific draft oblast-level regulations and procedures designed to improve the effectiveness of the

¹ The EAP Task Force, for which the Non-Member Countries Division of the OECD Environmental Directorate serves as a Secretariat, provides support to improve environmental policies and institutions in the New Independent States, including strengthening policy instruments and environmental finance mechanisms.

application of economic instruments and the coherence of the entire environmental management program in the Rostov oblast. The recipient of the report is the Rostov Oblast Committee for Environmental Protection and Natural Resources (Environmental Protection Committee, or EPC), but other appropriate agencies (see Section 2) are targeted by its recommendations as well.

Section 2 briefly presents the relevant institutional framework in the Rostov oblast. Section 3 analyzes the issues of pollution charge and water fee rates. The recommendations on improving revenue collection, including legal analysis and detailed guidance on enforcement of debt payment, are found in Section 4. Section 5 lays out the recommendations for the oblast to move to transparent, competition-based disbursement of resources for environmental projects. (Annexes 1, 2, and 3 contain drafts of an authorizing regulation and appropriate forms for a reformed disbursement process.) Finally, Section 6 comprises a discussion of suggested improvements in the environmental insurance and damage compensation system, which is further supported by a proposed draft oblast regulation on environmental damage assessment found in Annex 4.

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2. INSTITUTIONAL FRAMEWORK

Department of Natural Resources (DNR). As a result of institutional reforms at the federal level in May 2000 (that merged the State Committee for Environmental Protection into the Ministry of Natural Resources, MNR), similar changes occurred at the oblast level. They were complicated by the creation of the so-called Federal Districts (altogether seven in Russia) with powerful presidential representatives, with the Rostov oblast being part of the Southern District. The DNR for the Southern District is located in Rostov City and has a Division for the Rostov oblast. DNR issues and enforces permits for polluting activities and surface and groundwater use (for water users of less than 4 million m³ per year), as well as assesses respective charges based on self-monitoring data provided by enterprises. (The charge rates are approved by the Oblast Administration.) It is also responsible for inspections that serve, among others, to verify the accuracy of self-monitoring data used to calculate pollution charges and water fees. The DNR has severe staffing and funding problems: the reorganization has led to staff layoffs, plus it now has only federal budget funding (rather than money of the former oblast and local environmental funds). The DNR's staff has dwindled from 235 in 1999 to 105 in 2001.

Don River Basin Water Management Administration. This agency (known as DBVU, its Russian acronym) is also a branch of the MNR and is located in Rostov City, but it covers the entire Don Basin (several oblasts). It issues and enforces water use permits for major users (over 4 million m³/year) and designs water management projects. On the basis of water use permits, the Oblast Administration signs "water use contracts" with each individual user. DBVU also has certain water quantity and quality monitoring functions.

Rostov Oblast Environmental Protection Committee. The EPC is part of the Rostov Oblast Administration and was created in December 2000 in order to strengthen the oblast's environmental authority. The EPC has very limited statutory authority in terms of permitting, monitoring, and enforcement (although it has staff in municipalities and rural districts) but still exercises a lot of influence on environmental management in the oblast, since the Oblast Administration has the sign-off power on all important decisions of the federal agencies. Most importantly, though, the EPC manages 81% of the revenues from pollution charges collected in the oblast (19% goes to the federal budget) and a significant share of revenues from water fees. It is responsible for implementing environmental investment programs in the oblast, can control their implementation, and use other financial incentives for good environmental behavior by enterprises. The EPC has staff in all major municipalities and rural districts of the oblast.

Tax Authorities. The Federal Tax Ministry is responsible for collecting pollution charges and water fees (as well as other natural resource fees). Starting January 2001, environmental funds were abolished and all the money is distributed between the federal and oblast budgets. The Tax Ministry's Department for the Rostov Oblast enforces the payment of environmental and natural resource fees along with all other federal taxes, and such enforcement efforts have intensified since the promulgation of the new Tax Code in 1999. At the same time, the Tax Ministry provides the oblast's environmental agencies with very little information on environmental charge/fee revenue collection and debt (no information is available on revenues or debt by enterprise or even by type of industry). This issue is likely to be addressed, among others, in the coordination agreement on environmental monitoring and enforcement that is being prepared by the EPC, the DNR, and the oblast branch of the Tax Ministry.

3. CHARGE RATES

3.1 Pollution Charge Rates

The pollution charge system in Russia is based on the federal Law on Environmental Protection of 2002 (Article 16) and Government Resolution No. 632 of August 28, 1992 “On the Mechanism of Charge Calculation for Environmental Pollution Activities.”

The pollution charges are applied to all polluting enterprises. Charges are imposed on three types of polluting activities:

- air emissions from stationary and mobile sources (except private vehicles);
- wastewater discharges into water bodies;
- waste “placement” (storage and disposal).

There is a *basic charge rate* for each polluting substance (or type of waste) set at the federal level. The rate is expressed in rubles per ton of discharge. The federal regulation of 1992 states basic charge rates for 1993. Every year a Russia-wide inflation index is applied to this rate. In 2002, the inflation index is 111 for Russia, and it is directly applied in the Rostov Oblast. It means that all the basic charge rates laid out in the federal regulation of 1992 should be multiplied by a factor of 111 to calculate the rate for 2002.

The basic charge rates in Russia are differentiated by administrative region by using special multipliers - *coefficients of environmental conditions (CEC)*. In the Rostov Oblast, CECs are maximum 1.6 for air pollution and 1.9 for waste disposal, and from 1.26 to 1.85 for water pollution. Within these limits, all CECs are set by the Oblast Administration. Since the Rostov Oblast is part of the area protected under the international environmental convention on the Black Sea, CECs are magnified by a factor of two. In addition, the federal Environmental Law allows another 20% to be added to a CEC for emissions into the atmosphere by large industrial centers.

The Rostov Oblast has been using the CECs at almost the maximum for air and waste. There is, however, some space to increase the rates for wastewater discharges in some locations in the oblast, if necessary. It is possible under the existing federal regulations to raise the total coefficient across the oblast from the current 3.0 to 3.7 (in Rostov City, it is already at the maximum of 4.4).

Table 1 compares selected pollution charge rates in the Rostov oblast with those in the three Baltic countries that are part of the accession process to the European Union. The basic rates in Russia are significantly lower than in the Baltic countries, but the CECs used in the Rostov oblast make them comparable with the Baltic rates.

Table 1
Selected Pollution Charge Rates in Rostov Oblast (2002) and Baltic Countries (2000²),
EUR/ton

| Location | Air Pollutants | | Water Pollutants | | |
|---------------------|-----------------|-----------------|------------------|---------|------|
| | SO ₂ | NO _x | BOD | Total P | TSS |
| Russia (basic rate) | 1.3 | 1.6 | 2.9 | 45.5 | 12.2 |
| Rostov oblast | 4.1 | 5.3 | 9.6 | 136.6 | 36.5 |
| Rostov City | 5.8 | 7.5 | 13.0 | 200.4 | 53.5 |
| Estonia | 3.5 | 8.1 | 143.8 | 216.6 | 72.7 |
| Latvia | 17.9 | 17.9 | n.a. | 53.6 | 17.9 |
| Lithuania | 56.3 | 105.5 | 132.4 | 404.3 | 23.5 |

Total P – Total phosphorus; TSS – Total suspended solids; n.a. – not available

There are several exceptions in the application of pollution charge rates laid out in appropriate oblast regulations:

- For municipal solid waste (MSW), landfills have their rates reduced by a factor of five if they comply with the engineering standards. This measure was justified by the need not to place too much of a burden on households for waste generation. Currently, the MSW fee per household in the oblast is between 0.25% and 0.4% of the average household income. However, there are indications at least from the Rostov City Communal Services Department that the government is willing to gradually eliminate reductions for municipal solid waste charges.
- Sludge of municipal wastewater treatment plants (class 4 toxic waste) is charged at the rate 3.8 times lower than other wastes in the same class. The justification for this measure was that there were no facilities in the area for treating and disposing of this waste. The recent installation of a sludge dewatering facility in the City of Rostov may change the rationale for this rate reduction.
- Sulfides (including hydrogen sulfide) in the effluent of municipal wastewater treatment plants were exempted from pollution charges for many years. This exemption was controversial because the substances are highly toxic and have very high pollution charge rates associated with them. The official justification for it was that since even the smallest concentrations raise the charges by several orders of magnitude, it is better to use command-and-control mechanisms to eliminate such substances. However, a recent decision by the Rostov Oblast Administration revoked this exemption for 2002.
- The state irrigation enterprise Rostovmeliiovodkhoz has its pollution charges reduced by a factor of 10 (it used to be exempted altogether), because the DNR considers that the federal charge rates are suitable for “average” conditions in Russia but are inadequate for the agriculture in Southern Russia that heavily depends on irrigation. In addition, private farmers are not charged at all.
- All medical and educational institutions are exempted from pollution charges and water fees.

² *Environmental Taxes in an Enlarged Europe: An Analysis and Database of Environmental Taxes and Charges in Central and Eastern Europe*. The Regional Environmental Center for Central and Eastern Europe, October 2001.

Recommendation: Gradually eliminate the existing exemptions from pollution charges.

The pollution charge exemptions limit the revenue potential and do not provide incentives for reducing pollution. However, their elimination is likely to be a politically sensitive issue. In order to reduce the economic impact of scaling back such exemptions, the DNR should work with the EPC to come up with a schedule of gradual rate increases, particularly for the agricultural sector.

In the long term, the principal way to increase the incentive and revenue-raising impact of pollution charges is a complete restructuring of the rates at the federal level (to charge higher rates for a limited number of pollutants). In the short term, the only possibility at the oblast level is to revisit the current discretionary exemptions and scale them back as feasible.

3.2 Water Fee Rates

The rates of water fees in the Rostov oblast are set in accordance with the 1998 federal law “On Fees for Water Use,” at the upper end of the ranges allowed by the 2001 amendments to that law (effective January 1, 2002). They are set separately for water abstraction and wastewater discharge (by volume). The law differentiates between the use of surface water and groundwater (starting in 2002), and between uses for drinking water supply, industrial technological processes, cooling, hydropower generation, etc. The law sets reduced rates for municipal water utilities (for drinking water supply) and energy producers, and completely exempts agricultural water users from water abstraction fees. All these exemptions (covering the main water users in the oblast) are in force until January 1, 2003.

It is interesting to compare the actual water fee rates in Rostov with those in Central and East European countries (CEECs). One of the principal differences is that water fees in other countries are for water abstraction only and do not have a discharge component. In CEECs, water abstraction fee rates are differentiated depending on various factors. Parameters which may determine fee rates include: type of water abstracted (groundwater, mineral water, surface water), purpose for which the abstracted water is used (drinking water supply, irrigation, power generation, industrial use, etc.), and specific water scarcity regimes in a given locality. In general, the rates for groundwater are substantially (often by an order of magnitude) higher than for surface water. Specific rates varied from 7 EUR/1000 m³ in Romania to 90 EUR/1000 m³ in Poland in 2000.

Table 2
Selected Water Abstraction Rates in Rostov Oblast (2002) and Baltic Countries (2000³),
EUR/1000 m³

| Location | <i>Drinking Water Supply</i> | | <i>Industrial Consumption</i> | |
|----------------------------|------------------------------|---------------|-------------------------------|---------------|
| | Groundwater | Surface Water | Groundwater | Surface Water |
| Rostov Oblast ⁴ | 2.2 | 2.2 | 11.6 | 9.4 |
| Estonia | 25.5 | 15.9 | 47.8 | 15.9 |
| Latvia | 18.0 | 4.0 | 9.0 | 4.0 |
| Lithuania | 10.0 | n.a. | 24.0 | 1.6 |

n.a. – not available

³ Ibid.

⁴ Volume-based wastewater discharge fees in the Rostov oblast vary from 0.4 to 1.4 EUR/1000m³.

Differentiation by user type is also common. Usually the rates for industrial water use are about double those for drinking water supply (e.g., Slovakia, Lithuania). However, in some countries abstraction for drinking water supply is more expensive than for technological use in industry (Latvia). Water abstraction for cooling and hydropower generation is charged at much lower rates. In the Czech Republic and Slovakia, water users of less than 15,000 m³/year are exempted from abstraction fees altogether. Only Croatia differentiates the rates based on the quality of abstracted water (from 0.1 EUR/m³ for drinking water quality to 0.04 EUR/m³ for the lowest water quality).

Water abstraction taxation is not so commonly used in EU countries. It is applied in Germany and the Netherlands, with rates differentiated based on the use of water. The tax on groundwater in the Netherlands distinguishes between two uses: the rate for drinking water companies was 160 EUR/1000 m³, and for other industries 120 EUR/1000 m³ in 2000⁵.

Recommendation: Develop an equitable mechanism for differentiating the water fee rates both between groundwater and surface water and between types of water users in the oblast.

The current system of water fees in the Rostov Oblast is distorted by significant (federally mandated) exemptions reducing the flow of revenues and does not take full account of the differences between the sources and users of water. The anticipated expiration of these exemptions in 2003 gives Rostov oblast authorities a chance to achieve a better balance in the water fee rates. For example, fees for agricultural users should be introduced and gradually increased after January 2003. Other exemptions currently in place should also be gradually scaled back. The Don River Basin Water Management Authority and the DNR should elaborate specific proposals for these rate increases.

At the same time, differentiation based on the quality of abstracted water does not seem to be feasible at the present time. According to the information provided by the DBVU, there are no major differences in the quality of abstracted surface water across the oblast, most of it falling under Class 3 (moderately polluted). In addition, there is very little difference in technology (and costs) of pretreatment of abstracted water. Therefore, such differentiation would have a minimal equity impact but might lead to a significant loss of revenue.

⁵ Ibid.

4. REVENUE COLLECTION

The rates of collection of pollution charges and water fees have been steadily rising over the last three years: from 24% in 1999 to 65% in 2001 for pollution charges, and from 35% in 1999 to 63% in 2000⁶ for water fees. This dramatic recovery is attributed by most observers to an improving economy in Russia and the recent transfer of charge/fee collection functions from environmental to tax authorities. The other important factor is that the main debtor, the Novocherkassk Power Plant (responsible for over 75% of all water fees assessed in the oblast), undertook a restructuring of its arrears in 2001 and has partially repaid its outstanding debt (the late payment penalties were forgiven). It has also committed itself to paying current charges and fees in full.

However, a 65% collection rate still represents an unacceptably low level of collection. Other key debtors (the Rostov City Vodokanal, the Rostovugol and Gukovugol coal companies, and a number of state farms) continue to be a problem, and the penalties that are routinely imposed on them only increase the total amount of debt. This promotes a sense of unfairness in the system among those who obey the law and pay, and it also frustrates the environmental improvement plans of those who administer the law. The level of collection, while improved in recent years, warrants still further attention from Oblast officials. The goal should be 100% collection with a statistical variation of only about 5% for violations.

4.1 Enforcement Framework in the Oblast

The Oblast has a number of enforcement tools in its legal arsenal for the collection of debt. In some cases, these instruments represent stronger authority than that possessed by many Western countries. They also represent as wide an assortment of legal options as that generally found elsewhere in the international community. However, the weakness of the system is found generally in the lack of application of these legal tools to proper cases. The reasons are several: (1) lack of political will at a higher governmental level to take tough measures against economically and socially important enterprises; (2) unfamiliarity among both regulators and judges both with the new laws on creditors' remedies (means of debt collection) and with how they are administered in the justice system; and (3) lack of respect for the rule of law. In consequence of these weaknesses, personal accountability becomes very uneven, and the law is implemented inconsistently and chaotically. In short, the legal tools already exist for the most part but are not being properly applied.

In these circumstances, all that remains is that the Oblast re-arm itself with knowledge of the law and its implementation procedures, infuse itself with a new political will starting at the top, and then simply proceed to implement the law. The answer does not lie in some new legal formulation. Some changes doubtlessly will need to be made, but exactly where they should be made will come with experience in

⁶ The data on water fee collection for 2001 are distorted by large old debt payments, so the real collection rate is hard to infer.

applying the law. For now, government administrators need only to see the legal value in the enforcement tools that currently exist, and – the real challenge – to apply them consistently to every violator.

If this is done, the task of regulating will become easier over time. Early on, however, the task will be hard precisely because the regulated community has become accustomed to a lack of accountability in its environmental behavior. Accountability must become inevitable for the regulated community, and, therefore, expected. Compliance on a regular basis will follow shortly thereafter.

But what should government's overall purpose be in the enforcement of environmental laws? Enforcement should have some guiding principles, lest its functions become distorted, inconsistent and meaningless. First and foremost, the purpose of enforcement should be to dissuade others from committing the same offense, whether major or minor. Affecting environmental behavior on a positive basis should be the principal objective of enforcement. Punishment for the offense should be a secondary purpose, and certainly used, especially, for example, in criminal cases, but always with considerable discretion and for the sake of reinforcing the principal purpose.

4.2 The Order of Enforcement Priorities

This section explains in basic conceptual terms an international consensus on how to order priorities in the use of enforcement tools. Fundamentally, it is based on an escalating level of values that puts “money” on the lower end of the scale of importance (and the usual beginning point of enforcement), with “property” next, and the “person” at the high end. In other words, actions that seek compliance are ordinarily prioritized as the attachment of money first, the attachment of property second, and the attachment of the person himself (a jail term) third. Seriousness of the offense is implied in this escalation. Most enforcement activity is at the lower end of the values scale and involves the “attachment” of money. However, these are not definitive rules, and frequently enforcement tools are used to reach money and property at the same time.

Money: Since Russia relies on pollution charges and natural resource fees as the main economic instruments to manage environmental impacts, timely and regular payment by the regulated community of large sums of money is a constant compliance concern. At present, nearly one third (about 30%) of the total money owed by this community is delinquent. It should be emphasized that the larger public sector firms are the main debtors, while many smaller enterprises do not owe any debt. Thus, while the total delinquent amount remains unacceptably high, Oblast enforcement officials can focus on a relatively small number of delinquent enterprises.

The enforcement tools of choice for “attaching” money are the following:

- Bank Order
- Freeze Bank Account
- Debt Re-Structuring
- Bankruptcy

Property: Usually, the attachment of property is simply a means of satisfying a money debt. Thus, in a true attachment scenario, property that is secured by legal process may be sold to satisfy the debt. However, the *power* to attach property or the *power* to de-value property is also a powerful enforcement tool. Even the threat to exercise this power can have salutary effects. The threat may be used as a negotiating tool, but the government administrators should not ever make empty gestures. If the condition being sought is not implemented, the government should not hesitate to impose the sanction.

The enforcement tools of choice for “attaching” property are the following:

- Attachment of vehicles, equipment, raw materials, buildings, etc.
- Temporarily suspend or cancel environmental permit or license

Person: Attaching the “person” of the debtor is the tool of last resort. It is a criminal prosecution for intentional misconduct where the freedom of the accused person is at risk. The wrong behavior that is the subject of this sanction is *more* than the mere owing of money. It contemplates the *evasion* of the payment of money owed and/ or the act of *fraud* in so doing. The implementation of this single sanction will get the attention of the regulated community. Since it has the potential to take away one’s freedom, it is considered the most severe sanction. In Western countries, it has been extremely effective. It is used to prosecute enterprise officials at the very highest levels, and on average results in a prison sentence of one year (and often a personal fine as well).

4.3 Enforcement Options for Debt Collection in the Rostov Oblast

This section will offer a closer look at the enforcement tools that are available to the Rostov oblast, its Tax Department in particular. The discussion is structured in accordance with the order of priority set out in Section 4.2. Wherever appropriate, the consultants’ “additional guidance” is offered, based on international experience in using the particular enforcement mechanism under discussion.

Bank Order

The authority for bank orders is Article 46 on the collection of taxes, levies, and penalties out of monetary resources held in the bank account of a taxpayer, Tax Code of the Russian Federation (as amended by Federal Law No. 154-FZ of 9 July 1999). Principal provisions include:

- Tax obligations may be enforced through collection of money in bank accounts.
- Tax authority sends “collection decision” (bank order) to taxpayer’s bank after delinquency occurs, but not later than 60 days after that date. If later than 60 days, tax authority must seek satisfaction of the debt in a court.
- Bank order must identify taxpayer’s bank account(s). Loan and government subsidy (“budgetary”) accounts are exempted.
- Bank must execute the order “unconditionally” within one or two days, depending on the type of account, in accordance with the order of priority established by Russian civil law (pollution charges are the fourth order of priority).
- If there is insufficient or no money in the account, the bank order remains in effect until further money is received in the account.
- If there is insufficient or no money in the account, the tax authority has the right to collect the tax “out of other assets of the taxpayer,” in accordance with Article 47 (on “attachment” of property).
- For purposes of collecting the tax, the tax authority “may suspend operations on the bank account”, in accordance with Article 76 (the so-called “freezing” of the account provisions).

This is an unusually strong provision because it authorizes the invasion of a private bank account by administrative action. No judicial action is necessary. In effect, it represents an “attachment” of a bank account. Most Western countries, as a matter of law, would not permit this action without benefit of notice to the offender and an opportunity to defend against the imposition of a debt in a court of law. As a matter

of practice in the Rostov Oblast, however, when the taxpayer disputes the amount of the debt, and it cannot be resolved amicably, the dispute is transferred to the courts for resolution.

The tax authority under Article 46 may avail itself of the provisions of Article 47 to collect the levy out of “other assets” of the taxpayer (that is, property) when there is insufficient money in the taxpayer’s bank account.

Article 46 also authorizes tax authorities to seek, in parallel with the Bank Order, an order to “freeze” the taxpayer’s bank account pursuant to the provisions of Article 76. In practice, the authorities make an exception for salaries and social expenditures. The banks are required to advise the tax authority if the taxpayer changes bank accounts.

Additional Guidance: Use of the bank order can be a very effective strategy. Environmental authorities should first determine whether there is sufficient money in the account(s) to satisfy the debt, and, if so, file the “freeze” and the bank order simultaneously. If the money is insufficient, an alternative remedy such as attachment of property should be filed.

Freezing Bank Account:

The provisions for “suspension of operation on bank accounts” (“freezing”), while authorized in Article 46 on bank orders, are set out in greater detail in Article 76 of the Tax Code (as amended). Its principal provisions include:

- Suspension of operation of bank accounts may be used to enforce collection of a levy. It means cessation by the bank of all debit activities, except for payment of debts that rank higher in the priority hierarchy, as established by law.
- One way to suspend a bank account is for the tax authority to send a notice to the taxpayer with a deadline for payment, in which case the simultaneously authorized freeze order accompanies the deadline notice.
- Another way to invoke bank account suspension is failure to submit a tax declaration within two weeks of the expiration of the deadline.
- Tax authority shall notify both the bank and taxpayer, showing evidence of date of receipt, which date shall be strictly observed by the bank as the beginning of the suspension.
- Suspension of the account(s) shall be rescinded by the tax authority within one day of receipt of documents confirming compliance with the tax collection decision.
- Banks shall bear no liability for losses incurred by the taxpayer as a result of the suspension.
- *When suspension is in force, the bank shall not have the right to open new accounts for the organization.*

This is also a strong provision, again because it authorizes the impounding of money resources by administrative action and without a court order. Suspension or freeze of a bank account can be very disruptive to a business enterprise and threaten serious loss. A freeze order may be used in tandem with a bank order. See comments under “Bank Order”.

Worthy of note is the provision in Article 76 that forbids a bank, when suspension is in force, to open new bank accounts for the offending taxpayer. Yet, interviews with Oblast officials reveal that banks often do not keep the tax authority advised and do in fact open new bank accounts for their clients. Therefore, the enforcement of that clause against the banks would seem advisable.

Additional Guidance: It is extremely important that banks perform their responsibilities according to the law. Banks have operating licenses issued by the government, and presumably other vulnerabilities under

the law. The government should be firm in its expectation that banks offer their full cooperation when duly notified of their legal responsibilities.

While Oblast officials stated that “the banks are supposed to tell the tax authorities if an enterprise opens up a new bank account,” it does not specifically appear to us in Articles 46 (Bank Order) and 76 (Bank Account Suspension) that there is an affirmative duty on the part of the banks to advise the tax authority that a taxpayer, under order of the tax authority, has attempted to open a new account. This may be implied in Article 76, based on the above-referenced prohibition, but it does not appear to be *expressly* stated in either article. Accordingly, this omission may be an appropriate area for statutory amendment at the federal or, if possible, at the oblast level.

Debt Re-Structuring

According to the Budget Code (1998) and the Government Decree № 1002 (03.09.99). The tax authority has the right to negotiate with a taxpayer to accept less than its legal due under the statutes governing environmental and natural resource extraction levies. The bargain that may be struck is that the tax authority will cancel the late payment penalties upon full payment of current charges and fees.

A major re-structuring deal has recently been completed with the Novocherkassk Power Plant. According to Oblast sources, it promises to increase the current pollution charge and water abstraction fee collection rates and may constitute a model for other difficult cases. The agricultural machinery manufacturer, Rostselmach, is also reported to have agreed to re-structuring.

Additional Guidance: A tax authority has the discretion to grant “amnesty” to a taxpayer and to accept less than its legal due. The reasons that it is offered by tax authorities include the following: legal and administrative difficulty of collection; large sum is involved that could be put to beneficial public use; penalties have become unusually high in relation to the original debt; settlement would free up enforcement resources and be put to alternative uses; settlement would relieve stress to the system; and settlement would be seen by the public as a magnanimous gesture by government.

Re-structuring results from a negotiation process. The legal power favors the government side. Therefore, from a government standpoint, this process should be agreed to by the government, if at all, only at the end of the enforcement process when other enforcement mechanisms have either proved ineffective or have not been fully implemented because of potential social consequences. Ideally, the suggestion for its use should come from the enterprise rather than the government. The role of the government should be the application of pressure over time, using the other mechanisms strategically, so that the enterprise finally suggests payment of the original debt if the government will forgive the penalties. The agreed payment schedule can take many forms, depending on the negotiation, and stretch over many years. However, the government should insist that the agreement is conditioned on current and future payments being made as levied.

Bankruptcy

The authority for bankruptcy is the Federal Law on Insolvency (Bankruptcy) No. 6-FZ, January 8, 1998. The law (1) establishes grounds for bankruptcy, regulates application procedures, and regulates management during bankruptcy; (2) covers all commercial and non-commercial entities, except public enterprises; and (3) defines debtors as those unable to pay their liabilities to creditors or to pay mandatory taxes and charges. Principal provisions include:

- Bankruptcy grounds are (1) inability to pay liabilities within three months of their due date, AND (2) the aggregate liabilities exceeds the value of the debtor's property.
- Bankruptcy cases are reviewed by arbitration courts, which themselves may initiate a case if unpaid liabilities exceed a certain threshold linked to official minimal wage.
- The court may appoint, from among candidates proposed by the creditors, a "temporary manager" to analyze the financial status of a debtor, to ensure the safety of the debtor's property, monitor the financial condition of the debtor, and report on the possibility of restoring solvency. The temporary manager remains in place until the court appoints an external manager, declares the debtor bankrupt and initiate proceedings, approves a voluntary settlement, or rejects bankruptcy as a remedy.
- A court may decide, based on the creditors' recommendation and evidence, to appoint an "external manager". This appealable order shall extend for up to 12 months, and may be extended for another six months.
- Consequences of external management include: suspension of the debtor's chief executive and his replacement by the external manager; delegation of power of all management bodies to the external manager; submission to the external manager of all accounting and legal documents, seals, stamps, and valuables; moratorium on all monetary liabilities; manage the property within the bankruptcy framework.
- External manager manages the debtor's property, reviews the claims of creditors, and concludes a voluntary settlement on behalf of the debtor.

Oblast tax authorities report that bankruptcy is used as a last resort for "extreme cases of non-compliance." If other methods yield nothing and non-compliance begins to extend over a period of several years, or the money is owed by an absentee debtor, bankruptcy is considered. The tax authorities see the bankruptcy law in three stages: the first is an assessment of the financial condition of the debtor by a temporary manager. The second is the appointment of an external manager who can operate the enterprise and, in practice, seeks an agreement with the enterprise officers to pay off the creditors. The third stage is liquidation of the enterprise assets, with a proportional distribution to creditors, if no voluntary agreement can be struck.

Additional Guidance: The bankruptcy law was enacted in 1998, so there is relatively little experience in administering it by the Oblast. It operates on private property only, a relatively new concept in Russia. Its invocation requires (1) a three month delinquency for a mandatory levy, and (2) the debtor's liabilities must exceed his assets. The logic of this law is good. Creditors may discover the condition of the debtor in the first stage, take over the business to satisfy their debts in the second stage but leave it functional, or liquidate and end the business usually in only partial satisfaction of the debts in the third stage.

The second stage is particularly attractive as a creditor's remedy because it allows forcible repayment of debt from a recalcitrant private sector debtor, but keeps the business intact for the owner's use eventually. The Oblast may wish to be more aggressive in the use of this remedy, and not wait for "several years" of delinquency. A creditor's threat to file a petition in bankruptcy is often enough to get the debtor to a negotiating table, even if the debtor might not qualify as a bankrupt under the "liabilities exceeding assets" test (above). In Western experience, debtors often seek the "protection" of the bankruptcy law and voluntarily put themselves into bankruptcy so that they have time to work out a satisfactory solution with their creditors in order to avoid being forced into liquidation in bankruptcy. This Russian law also anticipates these conditions and allows the debtor to seek its "protection". As the Russian economy grows, the consultants believe that this law will receive increased attention. The tax authorities should seek appropriate cases to press this remedy.

Attachment of Property

The provisions for the collection of a tax or levy out of “other assets” of a taxpayer, while authorized in Article 46 (7) of the Tax Code on bank orders, are set out in greater detail in Article 47 of the Tax Code (as amended). These provisions, sometimes referred to as the “attachment” of property, include:

- Where there are insufficient or no monetary resources, or no information on the accounts, of a taxpayer, a tax authority can collect the levy out of “other assets” of the taxpayer, including his “cash resources,” securities, vehicles, finished products, raw materials, machine tools, equipment, buildings, installations, and “other assets,” in that order.
- The process is initiated by an order of the director (or deputy) of the tax authority issued to the bailiff (officer of the Ministry of Justice), containing the resolution of the tax authority, name and address of the taxpayer whose assets are to be seized, with dates and signatures.
- Cooperation between tax authorities and bailiff offices concerning enforcement of such attachment orders is carried out in accordance with the joint Order of the Ministry of Taxes and Levies and the Ministry of Justice of the Russian Federation of 25 July 2000.
- Bailiff must execute the order within two months of receipt.
- Tax authority officials shall not have the right to acquire assets from the sale.

Oblast tax lawyers think of the bank order under Article 46 as an enforcement first stage and attachment under Article 47 as a second stage. Some of the enforcement complexities associated with this staging arrangement are elaborated under the *Bank Order* discussion above. Since these procedures are taken in stages, the tax authorities ordinarily wait for “systematic evasion” before turning to this mechanism.

If the tax authority has sufficient reason to believe that the taxpayer may abscond or conceal his assets, it may seize the property at issue under Article 77 of the Tax Code with an authorization of a public prosecutor. Seizure of assets may be used only to secure collection of tax out of taxpayer’s assets in accordance with Art. 47.

In practice, if the amount of debt is in dispute, the matter is first referred to the courts for resolution. Such disputes are not common, however, according to the tax authorities. They also report that they have used the property attachment mechanism fairly frequently since the law was enacted in January 2001. Note that the tax authorities collect for *all* taxes, and state that when an enterprise is a debtor, it is usually for a number of obligations, including environmental levies. Under this procedure, the Russian Property Fund takes charge of the impounded assets, and informs the press and public of an impending auction. Auctions in the Oblast do not seem to be successful. Often, assets are not sold. The market is not very dynamic at this time, although it depends on the property, say the tax authorities.

Additional Guidance: The consultants recommend that the attachment mechanism be used more frequently, and that the tax authorities not wait for “systematic evasion.” This is complicated by the language in Article 46 (Bank Order), which appears to require that its provisions be satisfied first (seek a bank order) before proceeding to the attachment provisions under Article 47. There is no reason that bank order procedures be exhausted before being allowed to proceed to property attachment. Lawsuits should be considered to test this requirement, as suggested previously. At the same time, the Tax Ministry should recommend appropriate changes in the law to the State Duma.

Suspend or Cancel Environmental License

Oblast environmental officials report that a somewhat effective means of enforcement practiced today is the cancellation of the discharge permit (or water use license). The Water Code and the Law “On the Protection of the Atmosphere” state that the permit may be withdrawn if its conditions are being violated.

As the payment of charges is a necessary condition of a permit, serious delinquency may lead to permit revocation. In that event, enterprises immediately become liable for charges at a rate 25 times (5 times for water use) higher than the base rate. This works in a few cases, but in others it increases the accumulated debt. Shut-downs are problematic for political and economic reasons, especially with such “strategic” facilities as the power plant and Vodokanals. Thus far, this strategy, when it is applied, has been applied with respect to pollution permits, but not those for water abstraction

Additional Guidance: Environmental license suspension or cancellation should, in principle, lead to a shutdown of the enterprise. Thus, suspension or withdrawal of a license – or the threat to do so – is a powerful weapon. As mentioned above, the objective of enforcement is primarily to achieve compliance. Punishment is secondary, and punishment that suspends operations or shuts down an enterprise obviously hurts the community as well. Therefore, these remedies to enforce debt collection (1) should have credibility, and (2) should be used sparingly.

To have credibility, the industrial community must know that the government will use this enforcement mechanism if it must. But the government must exhaust the use of the other enforcement mechanisms first, i.e., bank order, attachment, debt re-structuring. And the government must pursue these remedies vigorously. Then, when the government has demonstrated to itself that it has tried all the remedies available to it at the lower levels of its enforcement hierarchy, then it may proceed with the license suspension or cancellation. However, once the DNR issues an appropriate suspension or cancellation notice, it must make sure that the enterprise is (temporarily or permanently) shut down.

Criminal Prosecution

Oblast officials report that criminal prosecution as a tax enforcement mechanism is not within the Oblast jurisdiction. Instead, it is within the competence of the “tax police” (under the Federal law “On Federal Tax Police” of 1993, as amended in 2000), a federal service that is independent of oblast tax authorities, and is under no ministerial jurisdiction. Action by the tax police is triggered by Oblast tax authority reports that reflect serious tax collection delinquencies that exceed action thresholds established by the tax police.

Additional Guidance: Criminal prosecution should be used in debt collection situations when the taxpayer intentionally tries to evade his lawful debt by fraud or deceit. The criminal suit is grounded in the intent to evade a lawful debt, and not necessarily the debt itself. An example of this behavior might be found in the opening of a second bank account when the first account is under a bank order. It is unclear to the consultants whether the element of “evasion” is necessary to ground the jurisdiction of the “tax police”; it may be sufficient that the tax debt is owed and not paid for a certain length of time.

The Oblast tax authority should be aware of the action thresholds of the tax police. The two bodies may wish to coordinate their administrative activities and agree on action thresholds that will promote compliance (if such thresholds are not otherwise governed by law). The objective should be to stimulate the further use of criminal suits as an enforcement mechanism.

Recommendation: *Rostov oblast environmental and tax authorities should use a combination of available enforcement tools strategically, according to the enforcement priorities (hierarchy) to increase collection of environmental levies and promote the principle of inevitable accountability in the regulated community.*

- Utilize a combination of a bank order and bank account suspension or go immediately to the attachment of property depending on the sufficiency of the debtor's cash reserves.
- Pursue debt restructuring only when other available enforcement instruments (short of bankruptcy) have been applied and proved ineffective, and only at the initiative of the debtor.
- Use bankruptcy, particularly its external management phase, more aggressively against private sector debtors.
- Exercise environmental license suspension as a last resort option, but having done so, make sure it results in a temporary (or permanent) shutdown of the enterprise.
- Use criminal prosecution against enterprise managers in cases of intentional evasion of environmental payments.

4.4 Accurate and Timely Assessment of Charges

Although pollution charges are supposed to be paid quarterly based on data for the elapsed quarter, enterprises often provide the information late and, in some cases, underreport their discharges. This leads to underestimation and delays of payments that are due, and further cripples the collection of revenue.

The accuracy of charge assessments is a problem in the Oblast. There is a lack of administrative control over the assessment process. DNR inspectors conduct joint inspections with the Tax Department, but, owing to staff shortages, they are able to only a small fraction of the enterprises. In these inspections, the Tax Department reviews only financial documents, while the DNR tries to compare actual discharges with the numbers submitted by the enterprises as the charge base. Even these limited inspections often discover discrepancies that point to the apparent desire of some enterprises to "hide" a portion of their discharges. Poor inspection coverage creates a serious credibility problem in the industrial community for the government and invites environmental non-compliance.

With respect to water fees, the problem of revenue collection is aggravated by the fact that only 25% of medium and small scale water users have licenses for water use. Such users need to be identified and charged for their water uptake and discharges (by volume) at a five-fold rate until they get an appropriate license. The system is unsustainable at this rate of licensure and deserves management attention.

Recommendation: Enforce license requirements and increase administrative inspections.

Solutions for the lack of accurate and timely assessment of charges lie in both (1) enforcement of license requirements and (2) increasing administrative inspections by the DNR in cooperation with the EPC. With respect to the first, enterprise managers must be held accountable for evading payments for water use (i.e., operating without a license), falsification, and late and/or incomplete reporting of discharge data. Administrative penalties should be meted out and vigorously enforced in ways set out above, and criminal conduct prosecuted in egregious cases. This is likely to require an increase in the legal staff of DNR. With respect to the second, increasing the number of inspection staff should be explored. Uncovering fraud, assuring the timely assessment of charges, and expanding the universe of licensed facilities will result in enhanced budget revenues that can be used to justify and pay for the increased inspection (as well as legal) staff. Heightened enforcement and inspection efforts will result in tighter control and the sustainability of the system.

4.5 Elimination of Offsets

Revenue collection was distorted by the use of “offsets” in the past. Until 2001, the Oblast authorized a system under which enterprises could keep a part of their pollution charges in exchange for internal environmental investments (eligible under rather broad 1993 Federal regulations). The total amount of money available for offsets was planned at the beginning of the year, and then was distributed according to some investment “priorities” that had been established. To receive credit, enterprises had to prove that they already had spent their own money on an eligible project and had achieved “some” results. While the design was creative, the offsets in practice were often granted to those enterprises which did not pay charges anyway, and thereby defeated the incentive contemplated by the pollution charge program itself. Thus, a well-intentioned program was abused to cover the revenue collection deficit. In 1999, a total of 21.6 million rubles was offset, including 5.3 million for the Novocherkassk Power Plant; 3.4 million for Rostovenergo; 1.4 million for Gukovugol; 0.8 million for Taganrog Vodokanal; and 0.1 million for Rostov Vodokanal.

In the 2001 Rostov Oblast budget, the line in the Oblast regulation allowing offsets was eliminated, making that the first year without offsets since they were first introduced. The Oblast Environmental Protection Committee is willing to maintain this position, but wishes to find other incentives to induce enterprises to undertake environmental improvements. The consultants suggest that those could include grants, loan guarantees, bank interest subsidies, among others, and are further discussed in Section 5. Such incentives, or any others that might be devised, should be limited to those enterprises that demonstrate their good faith by paying their discharge fees, and to those projects that are defined as priorities by the government. Offsets, as they were practiced by the Oblast in the past, should be abandoned for good.

5. REVENUE DISBURSEMENT

There are two budget lines in the oblast budget that are related to environmental protection and managed by the EPC:

- 1) the environmental budget line (81% of the total pollution charge revenues – the combined share of former oblast and local environmental funds), and
- 2) the water resource protection budget line (formerly, the Fund for the Restoration and Protection of Water Bodies) comprising *no less* than 50% (according to the federal law) of the oblast share of revenues from water fees (the other 50% go to the general oblast budget). The oblast share of water fee revenues went up from 60% to 100% starting in 2002. Effectively, the Oblast Administration may earmark up to 100% of water fee revenues to the water resource protection budget line, but so far has not been doing so.

The actual earmarked funds in 2001 were 83.5 million rubles (3 million euros) in the environmental budget line and 14.3 million rubles (0.5 million euros) in the water resource protection budget line. The respective figures planned for 2002 are 95.4 million rubles (3.4 million euros) and 97.2 million rubles (3.5 million euros). The dramatic increase of the water resource protection budget line is due to the two-fold water fee rate increase in 2002, the allocation of the entire revenue to the oblast budget, and the resumed payments of the Novochoerkassk Power Plant.

Currently, the EPC spends the revenue on grants for environmental projects, with about 80% of the funding going to support existing government programs (without any process for selecting priorities within each program), and the remaining 20% used for ad-hoc needs. In allocating the available funds, the EPC is guided by several federal and oblast-level programs, such as “Drinking Water,” “Environment and Natural Resources of Russia” (federal), etc. There is no carry-over between years for these budget resources. Therefore, if the money is not spent in a given year, it is forfeited.

At present, there is no assessment of projects on environmental, economic, or financial merits, making the use of scarce resources highly ineffective. The existing system does not include provisions for a formal application process, project cycle management, transparent procedures or accountability.

5.1 Transparent Project Cycle

The combined budget of almost 7 million euros is a tangible resource the EPC can use to support environmental activities in the oblast directly and leverage funding from other sources, including foreign donors and international financing institutions. In order to fulfill its responsibility of proper administration of public money, it needs to adopt a clear, detailed procedure for the evaluation of potential projects to be supported. Such a procedure would offer equal opportunities for all applicants and maximize environmental and cost effectiveness of public spending on environmental protection.

Before the EPC can apply a project selection procedure, it must set priorities for the types of projects it will finance. This annual exercise (a Financial Plan) may specify general plans for allocating certain shares of oblast budget resources to project categories (for priority environmental sectors), stipulate the sizes of projects the EPC plans to support, and/or allocate funds by type of applicant (public or private entity) or disbursement methods (see Section 5.2). The relative value of funds allocated to a given category of projects may be guided by long-term government-approved programs, or priorities may be defined during the annual budget preparation and approval process.

The project cycle is the process by which the EPC would review, select, and finance project applications (see Figure 1). The project cycle includes five steps:

1. *Application process.* Applications may be submitted either at the applicant's initiative (using an approved standardized form) or, in cases of specific needs, in response to a request for proposals by the EPC. The specially assigned EPC staff check the application for completeness, verify the applicant's eligibility, and request additional information or revisions of the application as needed.
2. *Project appraisal and selection.* EPC staff, sometimes with the assistance of outside experts, evaluate applications. (See Section 5.3 for the discussion of project appraisal.) Recommendations are then made to the head of the EPC who makes the final decision.
3. *Negotiations and financial awards.* Appropriate EPC staff prepare a contract and negotiate with the applicant contract provisions such as schedule of disbursements and monitoring and reporting requirements. The EPC or its financial intermediary disburses money to the applicant.
4. *Monitoring and implementation.* The EPC staff follow the applicant's progress in implementing the project. If the financing support is not used for its intended environmental purpose, or the planned environmental effect is not being achieved, the EPC should terminate further disbursement for that project and may demand that the funds already disbursed be returned.
5. *Evaluation.* Ideally, the EPC should make a determination if the project, once completed, has actually achieved the environmental improvements described in the application. This evaluation is standard practice among international financial institutions such as the World Bank and EBRD.

The design of the project cycle should be adapted to the expected volume of applications, the budget resources available, and the staff resources. In any event, the introduction of an application and appraisal process will require a significant public awareness effort among potential applicants and training for EPC staff and applicants.

5.2 Disbursement Methods

As mentioned above, the EPC currently uses only *grants* to finance public sector projects. Grants do not require repayment by the applicant and are, therefore, the most attractive option for applicants. The use of grants requires less attention in the appraisal process to financial characteristics of the applicant.

By Russian law, budgetary funds cannot be given as grants to private entities. In order to encourage environmental investments by private enterprises and replace the old system of offsets, the EPC is willing to explore other disbursement methods. Based on the range of choices presented by the consultants, the stakeholders expressed their preference for two such methods: loan interest subsidies and loan guarantees.

Under an *interest subsidy* scheme, the applicant would secure financing from a bank (or other commercial lender) with which EPC has signed an appropriate contract. The EPC would approve a lower interest rate for the applicant and compensate the bank for its loss in interest from not loaning at prevailing market rates of interest.

A *loan guarantee* is a form of financial support that reduces a bank's risk in lending money to the applicant when the applicant lacks appropriate or sufficient collateral to justify a loan decision without the guarantee. Under certain conditions stipulated in a contract between the bank and the guarantor (in this case, the EPC on behalf of the Rostov Oblast Administration), when the borrower defaults on its loan repayment obligations, the guarantor is responsible for repaying the balance of the loan or a portion thereof.

The use of interest subsidies and loan guarantees increases the complexity of the project cycle. Under a contract between the EPC and the bank, the bank would be responsible for initial financial appraisal of the project and the applicant's creditworthiness, followed by the environmental and technical appraisal eventual project selection by the EPC. Figures 2 and 3 illustrate the project cycles for a grant scheme and for a interest subsidy/loan guarantee scheme, respectively.

In the future, the EPC could also consider disbursing resources through soft (low or zero interest) loans. The best way would be to share the risk with commercial banks, which can be contracted to conduct financial due diligence and credit analysis, as well as on-lend oblast budget funds to final borrowers.

There are several dangers associated with disbursement methods that rely on cooperation with banks (interest subsidies, loan guarantees, and soft loans). With respect to interest subsidies, it should be ensured that the bank does not use the government's interest subsidies to increase its own profit (by inflating interest rates for an environmental project and having the EPC cover half the rate). The EPC should take preventive measures against this type of abuse by maintaining competition between banks that would sign contracts with the EPC and by introducing appropriate provisions to these contracts. Contracts should be signed with several (more than two) banks, and potential beneficiaries should be informed of all such banks with a suggestion that offers be compared. The EPC may also check what interest rates banks apply to beneficiaries and react appropriately in the event of any inconsistencies (overly high interest rates). In addition, contracts with cooperating banks should require banks to extend long-term (at least 3-year) loans, because most environmental investments (with the exception of low-cost cleaner production investments) have a relatively long payback period.

5.3 Assessment of Environmental Projects

The EPC should introduce competition between projects that are candidates for funding. The elaboration of project selection criteria makes the process more transparent to applicants, auditing authorities, and the general public. Selection criteria also help applicants to prepare their proposals and, in the event their projects are rejected, provide a basis for the EPC to convey reasons for rejection. At a minimum, the selection criteria should include the project's environmental impact, costs (total and the share to be subsidized), technical feasibility, and financial viability of the applicant.

Environmental and technical factors should be assessed by EPC staff. "Hard" criteria (i.e., those the applicant must meet to be eligible for financing) may include compliance record, consistency with existing policy priorities, choice of technology, etc. The EPC can contribute to improved collection rates for pollution charges and other environmental fees by making the absence of delinquency on these payments a "hard" eligibility requirement to receive financial support from the oblast budget. The level of

conformance with the “soft” criteria is expressed in absolute numbers and “weighted” to calculate an aggregate indicator of environmental impact. The aggregate indicator is then used to build a ranking list for the selection of best projects.

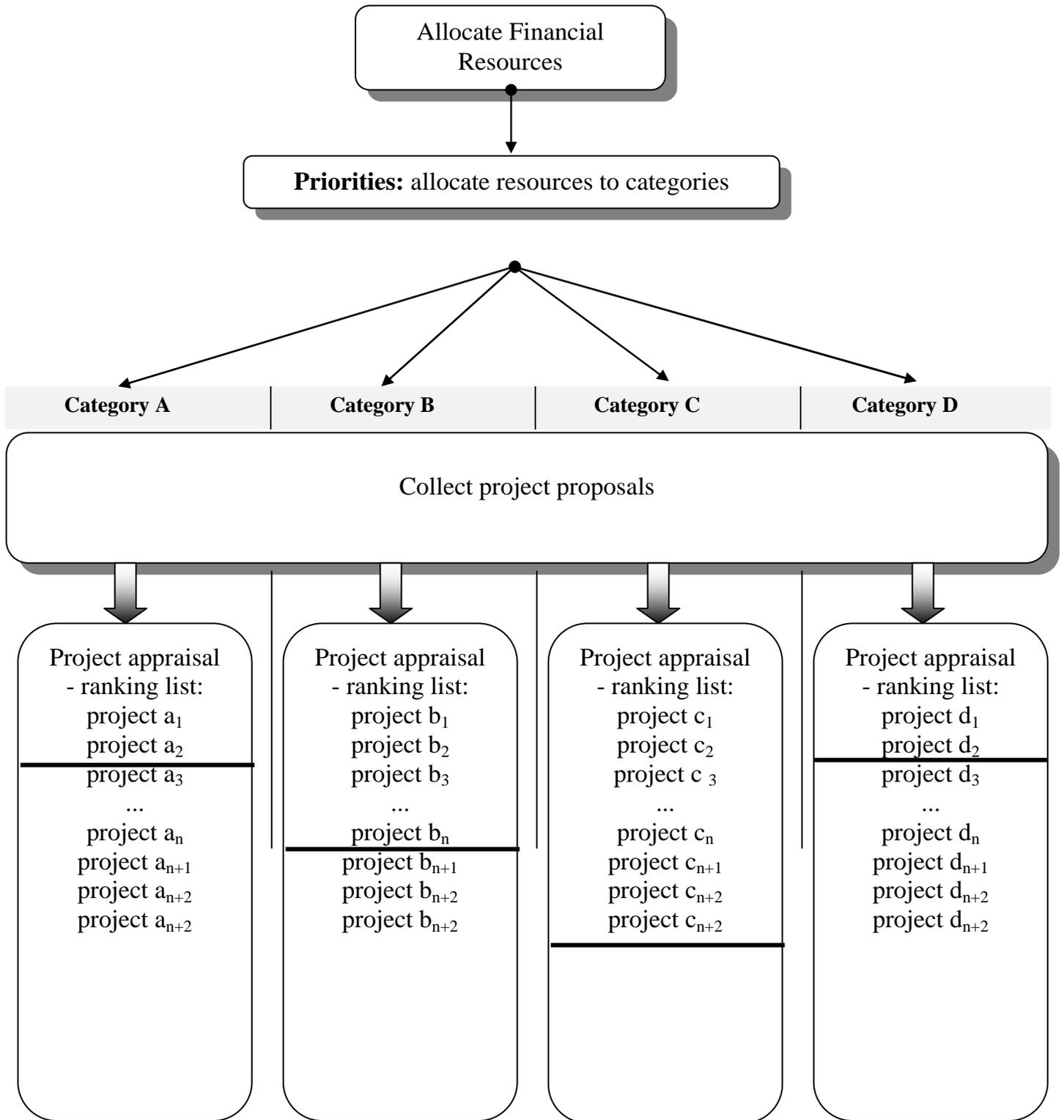
The financial assessment covers the project’s financial feasibility, the applicant’s creditworthiness (when a bank loan is involved), and the budget subsidy’s share of the total project cost. For environmental investment projects, the ratio of the monetary value of the subsidy to the aggregate indicator of environmental impact (i.e., the unit cost of environmental improvement) is a measure of its cost effectiveness⁷. This ratio forms a basis for the *ranking* to select the best projects (within each project category in the EPC Financial Plan) up to the point where no more funds are available for a particular project category. The EPC may want to establish a threshold for the relative unit cost of proposed projects, for example, by not financing projects for which the cost-effect ratio is more than 30% higher than the historic average.

Recommendation: *Adopt a revenue disbursement procedure (oblast regulation) and application and appraisal forms for financing environmental projects from the Rostov oblast budget.*

In **Annex 1**, the consultants propose draft “*Rules for Awarding Grants, Loan Interest Subsidies and Providing Loan Guarantees for Environmental Projects from the Rostov Oblast Budget*” for promulgation, after necessary amendments, by the Rostov Oblast Administration. The draft lays out a transparent procedure for using three disbursement methods (grants, interest subsidies, and loan guarantees) to support, on a competitive basis, environmental projects in both the public and private sectors.

The regulation would be supplemented by an “Application Form for Financial Support for an Environmental Project” (a draft is provided in **Annex 2**) and an “Appraisal Form for an Environmental Project” (see a draft in **Annex 3**). Both of these forms are accompanied by user-friendly instructions.

⁷ In the future, it is recommended that project appraisal take into account detailed financial data on the entire project (including capital costs, operation and maintenance costs, annual costs, and project lifetime cost). Doing this would require financial expertise that the EPC currently does not possess, which is why this recommendation was not proposed at this stage.



Cut-off line: Below this line, no resources for financing projects remain; project a₁ has a higher cost effectiveness than project a₂, etc.

Figure 1. General Overview of the Project Selection Process

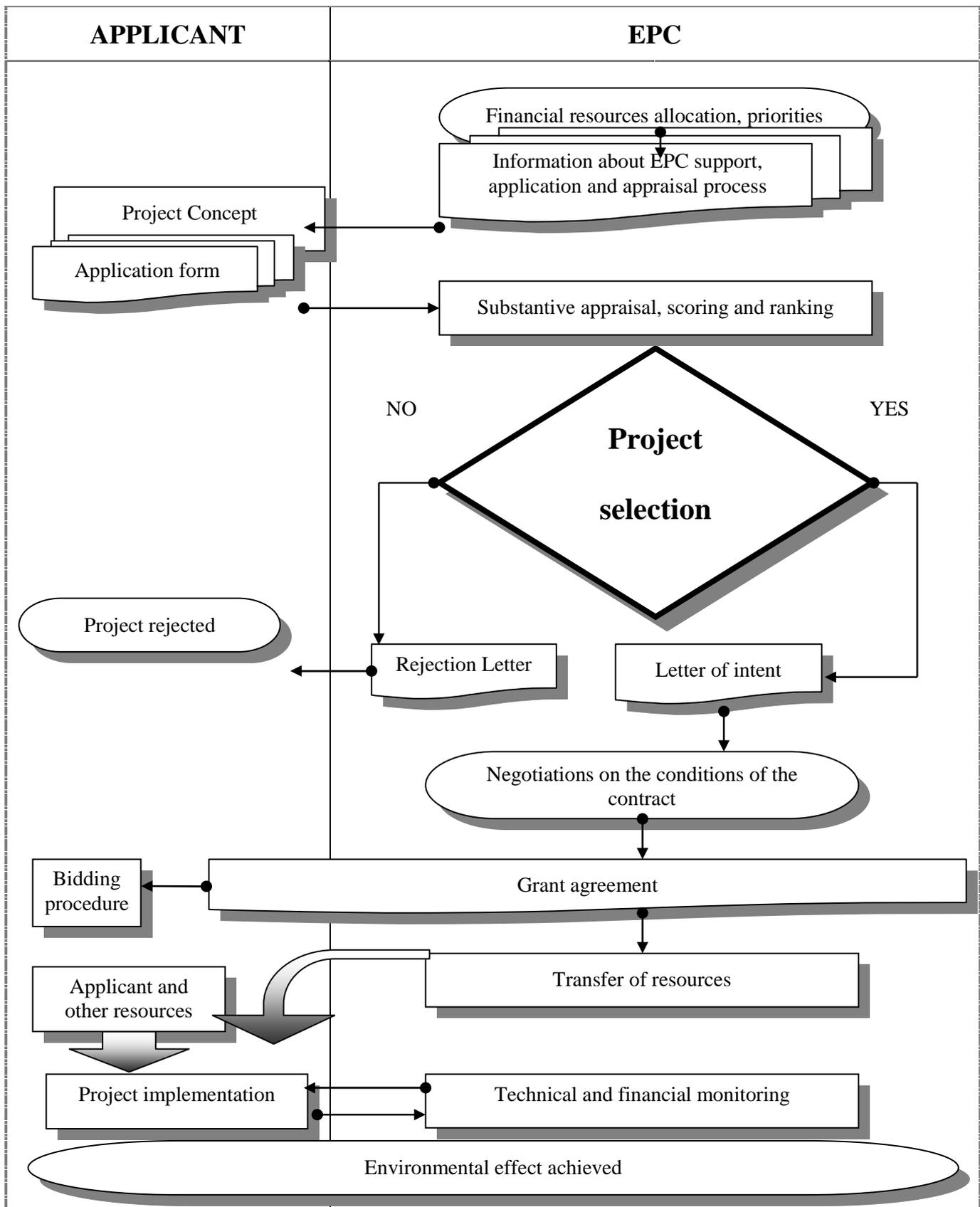


Figure 2. Project Cycle for Assistance in the Form of Grants

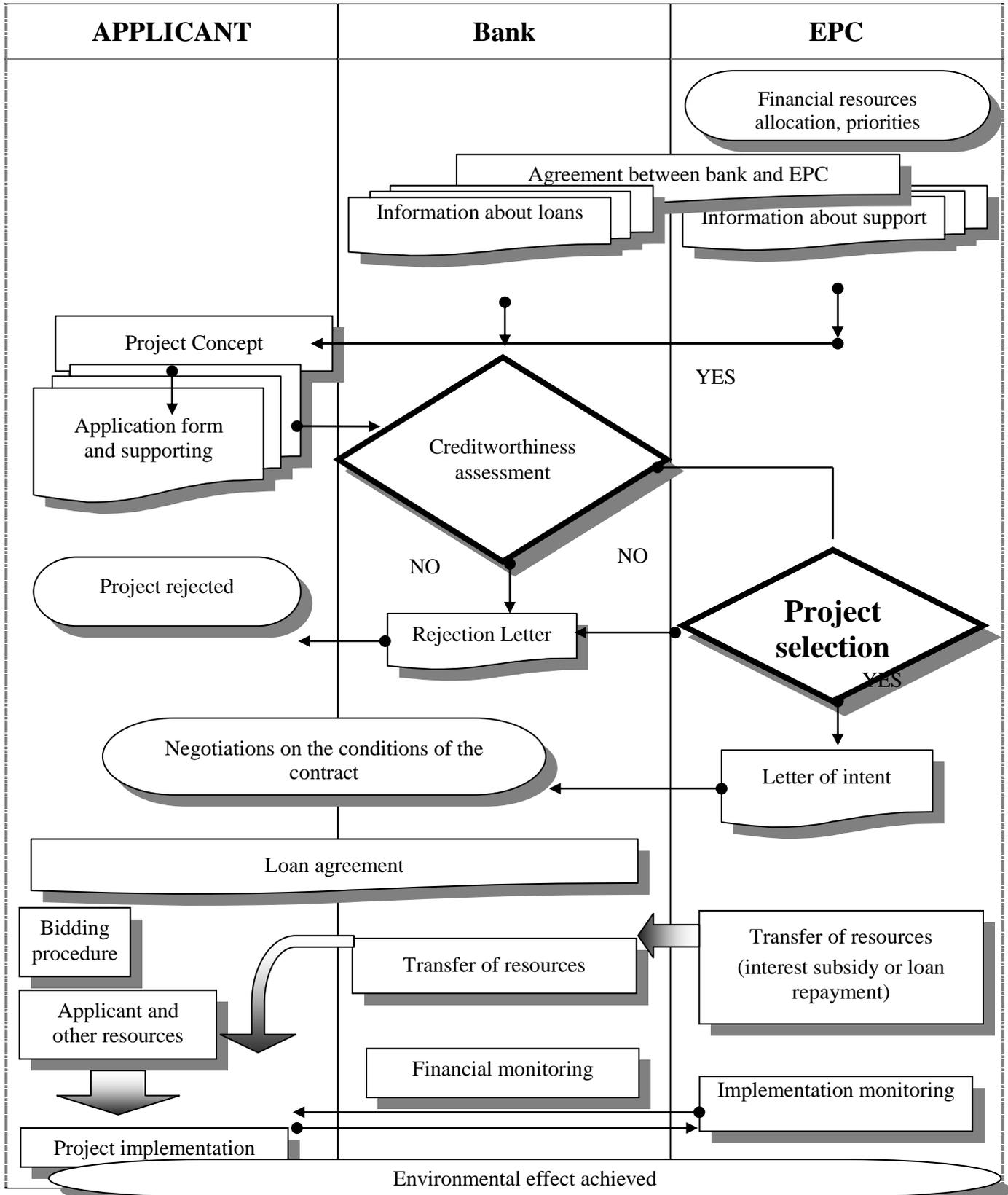


Figure 3. Project Cycle for Assistance in the Form of Loan Interest Subsidies and Loan Guarantees

6. ENVIRONMENTAL INSURANCE AND DAMAGE COMPENSATION

6.1 Environmental Insurance

The Federal Law No. 116/1997 “On the Safety of Hazardous Industrial Facilities” (Art. 15) and the implementing guidelines of the Ministry of Finance of March 31, 1998 *mandate* environmental insurance for “hazardous industrial facilities” (defined as those generating, using, treating, storing, transporting, or disposing of hazardous substances or wastes). The law requires a minimum amount of 1 million rubles of insurance for facilities handling less than a specified amount of hazardous substances, and 7 million rubles for those that exceed that amount. Only insurance companies approved by the Ministry of Finance are eligible to insure environmental risks. The type of coverage required by the law is for liability to third parties, including physical and juridical persons and the state. Only “accidents” are considered insurable events (defined as “uncontrolled explosions and/or discharges of hazardous substances” into any medium). Damage compensation payments must be approved by the court. The amount of insurance payment is determined by the insurer “based on the document of technical investigation of causes of the accident, court decisions and other evidence of the size of the damage.”

The Federal Ministry of Emergency Situations and the Federal industrial technical inspectorate (Gosgortekhnadzor) are the implementing agencies for Law No. 116 (described above). Gosgortekhnadzor has generated an inventory of hazardous facilities in the Rostov Oblast, but this inventory is not only unknown to the general public but unavailable to other concerned government agencies. Interviews with government officials familiar with the current practice of environmental insurance in the Oblast (including representatives of the Federal Ministry of Emergency Situations) have revealed a large number of distortions and abuses of the system. Among them:

- The present insurance guidelines by the Russian Union of Insurers state that insurance payments are made on claims made within three years of the compensable accident. This restriction is in contradiction with Article 78 (3) of the new Law on Environmental Protection (2002) that stipulates that claims can be brought for up to 20 years following the compensable accident.
- The discrepancy between the term of an operating license for hazardous facilities (3 years) and the term of insurance coverage (1 year) required to obtain such a license. As a result, many facilities do not renew the insurance coverage when it expires until they have to renew the operating license.
- Potential inability of the vast majority of insurance companies to compensate potential damages. One reason for this is the inadequate assessment of insurance companies’ assets and financial strength prior to issuing them a license to offer environmental insurance. The other is artificially low insurance premiums caused by the competition among different insurance companies. The insurance companies generally do not anticipate that they will be liable for any environmental damages (see the discussion of the weakness of the liability system below) and view the premiums as pure income.

- Kickbacks to environmental authorities for promoting one or another insurance company among the regulated community. Currently, several insurance companies have signed agreements with the Federal Ministry of Natural Resources by which the ministry endorses them to offer environmental insurance. In exchange, the insurance companies pay a certain percentage (up to 15%) of the premium revenues to the government for environmental protection measures. Similarly, several insurance companies have approached Rostov's EPC and solicited its help in promoting their services. Such deals between regulators and insurance companies represent a clear conflict of interest. Moreover, the diversion of part of the insurance premiums to the government further reduces the insurers' ability to cover possible environmental damage claims.

It should be underscored that the core reason for the dysfunction in the environmental insurance system is the lack of damage compensation claims that would trigger, in turn, the real need for insurance coverage. If courts upheld damage suits, hazardous facilities would be incentivized to buy reliable insurance to protect them against their exposure to liability. Insurance companies would then be stimulated to set premium rates so as to accumulate a sufficient reserve, calculated by insurance underwriters, to cover anticipated claims by policyholders having legitimate insurance contracts, rather than share premiums with the government, as is now the practice. In other countries where insurance is integral to the system of environmental protection, the enforcement of liability by administrative and judicial means drives insurance industry viability. The need to radically improve the system of liability for environmental damage is discussed below.

6.2 Liability for Environmental Damages

Liability rules serve a dual purpose in environmental management. First, in the event of an accidental release of hazardous pollutants into the air, water, or soil, liability rules elaborate the polluter's responsibilities for compensating victims (assessing damages to third parties), cleaning up the release, and compensating the state as trustee for the environment (assessing damages to natural resources). Second, liability rules may encourage facilities to invest in pollution control and prevention, even if not required by the regulation.

In the Rostov Oblast, there are very few suits brought against polluters (hardly any by third parties other than the state) to make polluters interested in insuring themselves and taking preventive measures against environmental accidents. The "compensation for damages" suits (liability suits brought by the DNR on behalf of the state) have been used very seldom in recent years. One reason is that the last state-approved methodology for environmental damage assessment was issued in 1983 and would result in very small amounts of monetary compensation. New methodologies have since been developed, but they have not been published in accordance with Presidential Decree No. 763 (1996) so they are not considered valid for purposes of application at the Oblast level. They are also considered complex and difficult to present to the Arbitration Courts that handle such issues. This federal void on methodologies has led oblast environmental officials to realize the need for alternative damage assessment methodologies that would allow them to sustain their burden of proof in court and withstand the legal attacks of enterprises, which have resources that allow them to hire technical experts and seasoned lawyers to defend them.

The old Law on Environmental Protection (1991) provided that damages may be based on actual costs but only in the absence of a relevant methodology. The new Law on Environmental Protection (2002) reversed these priorities. That is, Article 78, para. 1 thereof specifically provides that damage assessment shall be made "based on actual costs for restoring the environment ... as well as according to environmental restoration and rehabilitation plans [and] in their absence, according to standardized costs and methodologies..." Thus, the Russian federal law has moved from a passive allowance of damage

assessment based on actual costs to its endorsement as the principal method of damage assessment. The legal implication of this policy reversal for the Rostov oblast is that now the oblast has to develop an implementing damage assessment regulation of its own, based on actual costs.

The collection of damages, even if awarded, presents the same difficulties of collection as do pollution charges and water fees. In these circumstances, according to Art. 78 (1) of the Law on Environmental Protection (2002), the plaintiff enforcement agency may ask the court to compel the enterprise to undertake certain abatement measures at its own expense and in line with a court-approved cleanup plan.

Since the judges are not experienced in environmental issues (there used to be specially designated judges for environmental cases, but this practice was abolished several years ago), the government often loses cases and is reluctant to go to court at all. Only one such suit was brought in the first half of 2000.

Recommendations:

1. Improve control at the oblast level over the implementation of the federal law mandating environmental insurance for hazardous facilities.

The necessary improvements include:

- Working with the Ministry of Finance to rigorously audit insurance companies to verify their ability to cover potential damage claims;
- Eliminating the practice of endorsement of particular insurance companies by environmental authorities in exchange for a share of premium revenues;
- Verifying that hazardous facilities buy insurance for the entire duration of the operating license. (This is especially compelling because the 2002 Law on Environmental Protection allows claims for up to 20 years following a compensable accident. From a legal standpoint, this will override present insurance guidelines that purport to limit an insurance company's liability to just three years.)

2. Develop an environmental damage assessment regulation at the Oblast level to implement such damage assessment based on actual costs.

The regulation should detail damage assessment procedures that may be followed by "third parties," which will include the Oblast, municipalities, and persons. Other methodologies, especially those based on standardized costs or categories of risk, are apt to be speculative and inaccurate. See **Annex 4** for a draft regulation that might be considered by Oblast officials. Actual costs of the selected remedy, the focus of the regulation, are to be estimated by professional engineers who are provided incentives to offer their professional services.

3. Work with the Ministry of Justice to establish a special court docket for environmental cases.

This would restore the former practice. If environmental enforcement is given Oblast support for a wide range of cases, there should be enough judicial activity to warrant special attention. The EPC, on behalf of the Oblast administration, should open a dialogue with the Arbitration Court and lawyer associations to plan educational seminars for lawyers and judges on the specifics of environmental cases.

Annex 1

Rules for Awarding Grants, Loan Interest Subsidies and Providing Loan Guarantees for Environmental Projects from the Rostov Oblast Budget (Draft)

ROSTOV OBLAST ADMINISTRATION

(Date)**(Number)**

Rules for Awarding Grants, Loan Interest Subsidies and Providing Loan Guarantees for Environmental Projects from the Rostov Oblast Budget

Article 1. Definitions

“Grant” means non-proprietary financial support for an environmental investment or non-investment project (such as research). The financial support is not subject to repayment, provided that all grant conditions are met as stipulated.

“Loan interest subsidy” means financial support to the borrower of a loan in the form of payment of the entire amount of interest due on a loan or a portion thereof.

“Loan guarantee” means a form of financial support that reduces a bank’s risk in lending money to the borrower when the borrower lacks appropriate or sufficient collateral to justify a loan decision without a guarantee. It means that under certain conditions, when the borrower defaults on its loan repayment obligations, the guarantor is responsible for repaying the balance of the loan or a portion thereof.

Article 2. General Provisions

1. The Rostov Oblast Committee for Environmental Protection and Natural Resources, hereinafter "EPC," awards grants to an entity, conditioned by contract upon certain requirements, for the purpose of implementing an environmental project from among the types of projects defined in the Russian Federation regulations (according to Article 15 of the Federal Law on Environmental Protection), upon review of an application submitted by that entity.
2. The EPC provides assistance to an entity implementing an eligible environmental project in the form of payments to cover a portion of the interest on a loan, negotiated by the entity with a bank, upon review of an application submitted through the bank by that entity.
3. The EPC provides assistance to an entity implementing an eligible environmental project in the form of a loan guarantee, based on a contingent loan agreement between the entity and the bank, upon review of an application submitted through the bank by that entity.
4. The application for assistance shall be submitted using forms approved by the EPC. The EPC may make a written request for additional documentation and information essential to conduct proper evaluation of the application. The application will not be reviewed until the EPC has finished assembling such additional information. If the applying entity does not provide the requested documentation and information by a date presented in the written correspondence from the EPC, the application shall be cancelled.
5. The EPC informs potential applicants and the general public through media and other channels about its procedures and the opportunities to apply for financial assistance.
6. All decisions to award assistance shall be made by the head of the EPC, following the review procedures established herein.
7. The decision to finance an environmental project shall include the amount and type of financing (grant, loan interest subsidy, loan guarantee).

8. Financing shall be awarded in accordance with the priorities and criteria for selection of projects to be financed from the Rostov Oblast budget, as well as with annually approved priority measures and plans for EPC operations.
9. Entities eligible to receive grants, in accordance with Russian Federation law, are:
 - a) Local governments, for all projects listed under Article 3 (1)
 - b) Public research and educational institutions, for projects listed under Article 3 (1-f).
10. Private sector entities are eligible to receive loan interest subsidies or loan guarantees for projects listed under Article 3 (1-a) – 3 (1-e).
11. Grants and other forms of support shall not be awarded for projects or their components completed before the date of the EPC financing decision.
12. A bank loan and loan guarantee supported by the EPC or a grant from the oblast budget may be awarded to entities that have no delinquent payments of pollution charges, fines, or other environmental fees due from it.
13. Costs and fees associated with providing and servicing loans, loan guarantees or grants shall be covered by the borrower or grantee.
14. Financing may be taken from the oblast budgetary funds provided that the applicant demonstrates that full accounting of project costs and their financing have been secured.
15. Recipient entity payment orders pre-dating the date on which the financing decision is made may not serve as a basis for transferring funds.

Article 3. Eligible Projects

1. Rostov Oblast budget resources may be used to finance the following types of environmental projects:
 - a) Construction of sewer systems and wastewater treatment facilities,
 - b) Construction of hazardous or municipal solid waste landfills, as well as waste treatment (e.g., incineration, composting, etc.),
 - c) Construction or modernization of air pollution control installations,
 - d) Water resource protection projects,
 - e) Industrial cleaner technology projects,
 - f) Non-investment projects: environmental education, development and implementation of environmental monitoring systems, flora and fauna protection, and scientific research and feasibility studies in the area of environmental protection and water management.

Article 4. Awarding Grants

1. The EPC awards grants to entities in accordance to Article 2 (9) herein.
2. The grant agreement shall define in detail the following terms and conditions:
 - a) The amount of grant award,
 - b) The beginning and end dates of the project to be financed, as well as the planned environmental effects,
 - c) The date the grant, or its installments, will be transferred,
 - d) The EPC's rights to control the awarded grant as well as the method of securing possible return of the grant,
 - e) Particular grantee obligations arising under this or any other article herein,
 - f) Conditions under which the contract loses its force,
 - g) Consequences of contract dissolution.
3. The maximum level of a grant for one project may not exceed 50% of the funds earmarked for the applicable type of project in the approved EPC annual financial plan.
4. The grant awarded from the Rostov Oblast budget may not exceed:
 - a) 75% of investments in construction of sewer mains and wastewater treatment facilities,
 - b) 75% of investments in water mains supplying water to households and industry,

- c) 75% of investments in solid waste landfills,
 - d) 80% of investments in waste management (e.g., incineration, composting, etc.),
 - e) 50% of investments in construction or modernization of air pollution control installations,
 - f) 50% of investments in cleaner industrial process technology,
 - g) 100% of non-investment projects.
5. The grant may be transferred to the applicant all at once or in installments (tranches).
 6. A portion of the grant may be transferred in advance at a level up to 20% of the total value of the project, in cases when the lack of this advance would render project start-up impossible.
 7. The grantee that has received an advance on a grant is required to return to the EPC any interest income resulting from holding the grant in its bank account.
 8. Dates for making grant transfers are determined by the EPC based on funds at its disposal and upon consideration of an applicant's proposal presented in the application.
 9. Financial resources from the grant are transferred exclusively for the purpose of meeting payments required of the grantee. The investor shall allow the EPC full access to original invoices prepared by contractors or suppliers.

Article 5. Modification or Termination of a Grant Contract

1. The EPC may terminate the grant contract in cases where:
 - a) The grantee does not commence implementation by the agreed date or withdraws from its intent to achieve the purpose for which the grant was awarded,
 - b) The grant or portion thereof was not used in accordance with its intent, as established in the grant agreement,
 - c) The planned environmental effect (as established in the project timeline) has not been attained,
 - d) The grantee fails to meet other conditions stipulated in the agreement.
2. In the event that the grantee does not conform to the conditions stipulated in the agreement, the EPC may withhold further grant payments and may also demand return of the portion of the grant already awarded, as well as assess fines.
3. Parties may agree to new agreement conditions in the event that circumstances arise that alter the project implementation conditions and over which parties have no control despite appropriate effort, as well as in other justified cases.
4. New conditions (as contemplated under the previous section 3) must be addressed in a supplemental application and be submitted no later than the last day of execution of or settling of accounts associated with the project, depending on the element to which the new conditions apply.

Article 6. Awarding Loan Interest Subsidies

1. The EPC awards financial support to entities executing environmental projects listed in Art. 3 (1-a) – 3 (1-e) by paying a portion of interest costs on a loan drawn from a bank with which the EPC has signed an appropriate contract.
2. The contract between the EPC and the bank shall contain, at a minimum, provisions for:
 - a) Bank obligations to check the financial condition of the applicant and to inform the EPC on the applicant's sufficient creditworthiness,
 - b) The validity period of the contract between the EPC and the bank. The validity period should be longer than the maximum loan payment period.
 - c) The maximum loan repayment period (10 years) as well as maximum grace period in commencing repayment of loan principal (12 months).
 - e) Restrictions in changes in adjustable interest rates,
 - f) Bank obligations on informing the EPC of all changes in the loan interest rate as well as rules for issuing loans.

3. The applicant shall submit an application to the bank (with which the EPC has signed a contract), which contains information required by the bank in order to establish the applicant's creditworthiness.
4. The bank shall transfer the application to the EPC within 14 days of establishing the applicant's creditworthiness. The bank shall include in this submission a loan payment simulation prepared by the bank and the original loan application. The application is then reviewed by the EPC using the application review cycle outlined in Article 10.
5. The EPC shall inform the bank of its decision within 10 days after making the decision.
6. In the event of a positive decision of the EPC, the bank may issue the loan to the applicant.
7. The bank shall include the following provisions in the loan contract with the borrower, which shall not be inconsistent with the provisions of this regulation:
 - a) The rights of the EPC with respect to controlling how the loan is used and whether the environmental effect is achieved,
 - b) Circumstances that justify termination of the contract prior to full loan repayment, including the breach of contract obligations by the borrower,
 - c) Consequences of termination of the contract.
8. The bank, in its contract with the client, is obliged to take into account the possibility that the EPC may demand a return of interest payments if the environmental effect has not been achieved as stipulated. In such an instance, the bank has the obligation to execute the return of the EPC's interest payments and transfer them back to the Rostov Oblast budget.
9. The bank shall provide the EPC with a copy of the contract with the borrower.
10. In the event of a change in interest rate, the bank shall, within 14 days, provide the EPC with a new loan payment plan for contracts approved and signed by the EPC.
11. The EPC shall transfer its loan interest subsidy payment to the bank within 10 days of EPC receipt of bank confirmation of the borrower's full scheduled payment on the loan.

Article 7. Termination of Loan Interest Subsidies

1. The EPC may demand withdrawal from the loan contract before full payment of the loan if it is determined that:
 - a) The borrower has not proceeded with investment implementation according to the approved schedule or has decided not to implement the project for which the loan has been issued,
 - b) The loan or a portion thereof has been used in a manner inconsistent with its intent, as stated in the contract,
 - c) The planned environmental effect has not been achieved as defined in the application,
 - d) Loan repayment is not proceeding according to schedule.
2. In the event of a demand for withdrawal from the loan contract, the EPC ceases to make interest payments and may demand that payments already made be returned.
3. The bank, in instances under Art. 7 (1), and subject to agreement with the borrower, may sign a new contract with the borrower or change the type of loan to general, without loan interest subsidies from the Rostov Oblast budget.

Article 8. Providing Loan Guarantees

1. The EPC provides financial support to entities executing environmental projects listed in Art. 3 (1-a) – 3 (1-e) by providing loan guarantees for loans drawn from a bank with which the EPC has signed an appropriate contract for the purpose of financing environmental projects.
2. A loan guarantee extended by the Rostov Oblast Administration for an environmental project may not cover more than 50% of the bank loan for that project.
3. The contract between the EPC and the bank shall include at a minimum:
 - a) The bank's obligation to review the financial condition of the applicant as well as to certify its creditworthiness,

- b) The validity period of the contract between the EPC and the bank. The validity period should be longer than the maximum loan payment period.
- c) The bank's obligation to inform the EPC on all changes in rules for providing loans.
- 4. The applicant shall submit an application to a bank with which the EPC has signed a contract. The applicant shall also submit the necessary documentation required by the bank in order to establish the applicant's creditworthiness. In the event of a positive assessment of creditworthiness, the bank forwards the application with supporting documentation to the EPC within 14 days of the positive assessment. The application is then reviewed by the EPC in accordance with Article 10.
- 5. EPC has 14 days to inform the bank of its decision.
- 6. If the EPC delivers a positive decision and issues a loan guarantee with the approval of the Ministry of Finance of the Rostov Oblast Administration, the bank may provide a loan to the applicant, securing the remaining portion of the loan in accordance with normal banking procedures.
- 7. The bank shall include the following provisions in the loan contract:
 - a) The rights of the EPC to control how the loan is used and whether the environmental effect is achieved,
 - b) The reasons for and consequences of contract termination.
- 8. The bank shall provide the EPC with a copy of its contract with the borrower.
- 9. The bank shall include in its contract with the borrower the possibility that the EPC may withdraw the loan guarantee in the event the environmental effect is not achieved. If by the time this non-conformance becomes evident and the guarantee is withdrawn, the loan has already been disbursed, the loan shall be subject to re-negotiation between the bank and the borrower.

Article 9. Default on a Loan Guaranteed by the Government

- 1. In the event that the borrower defaults on loan repayment, the bank shall initiate regular debt recovery measures against the borrower, including bankruptcy procedures.
- 2. The bank shall grant the EPC access to documentation on its debt recovery measures, and shall demonstrate to EPC's satisfaction a good faith effort to recover the debt.
- 3. Only in the event that loan repayment is impossible (i.e., the value of the debtor's assets after liquidation is less than the value of debt), shall the Ministry of Finance of the Rostov Oblast pay the portion of the loan guaranteed by the EPC.
- 4. If the bank is able to recover the loan partially, the EPC shall reduce its payment proportionally.
- 5. Upon default by the borrower, the Ministry of Finance of the Rostov Oblast shall transfer to the bank the amount of the secured loan over a period of up to 12 months.

Article 10. Application Review Cycles

- 1. Applications for financing are accepted continuously throughout the year.
- 2. Applications for financing are reviewed on or around the following dates:
 - a) 28 February,
 - b) 31 May,
 - c) 31 August,
 - d) 30 November.
- 3. A complete application for grants shall be submitted to the EPC at least one month prior to the application review date:
 - a) 31 January,
 - b) 30 April,
 - c) 31 July,
 - a) 31 October.
- 4. A complete application for loan interest subsidies and loan guarantees shall be submitted to the bank at least one month prior to the application review date:

- d) 31 January,
 - e) 30 April,
 - f) 31 July,
 - g) 31 October.
5. Applications received later than the dates indicated in para. 3 and 4 herein shall be reviewed in the following cycle.
 6. The EPC shall use approved standardized application forms, evaluation forms and project selection criteria. The general and financial sections, on the one hand, and the environmental sections, on the other, shall be evaluated separately.
 7. The EPC may design special application forms and project selection criteria on a case-by-case basis for those types of projects for which no standardized forms have been approved. The EPC may request public and private entities to submit proposals to respond to specific needs it has identified.
 8. The EPC prepares an annual plan of expenditures, subdivided by quarter (for each application review cycle). In this plan, resources are divided for predefined project types and types of assistance. The division of resources for each project type should conform to the EPC's environmental policy priorities. The head of the EPC shall approve the annual plan of expenditures by January 31.
 9. The head of EPC appoints staff responsible for evaluating applications:
 - one person for maintaining a database of applications and filling out project appraisal and specification forms;
 - one person responsible for general and financial data evaluation and appraisal,
 - three persons responsible for environmental and technical data evaluation and appraisal.
 10. The EPC shall prepare separate ranking lists for grants, and interest subsidies/loan guarantees, and, under each of these types of assistance, for each type of project. For each ranking list, the projects receiving a positive decision will be quantified for the assistance each receives until all funds earmarked for the type of project in the application cycle have been exhausted.
 11. If the ratio of the value of the subsidy to the indicator of environmental effect (as defined in the approved appraisal form) is more than 30% higher than the historic average, the EPC shall not grant assistance under the assumption that the given project is too costly and that markedly better projects may be submitted in the next cycle. Where the historic average is not available, the EPC shall use standard engineering unit costs.
 12. The head of the EPC may take exception to the provision of Art. 10 (10) by a written decision with justification. In such a case, the project shall be evaluated normally.
 13. In the last cycle in a given year, the EPC may transfer unused resources from one project type to another, where there are significantly more projects that meet the established selection criteria.
 14. Decisions on financing are signed by the head of the EPC within 14 days of the date of application review.
 15. If an application is accepted for financing, EPC informs the applicant in writing within 14 days from the date of the decision and prepares to sign a contract with the applicant.
 16. The applicant is required to submit to the EPC all documents required for contract signature within 1 month of the date of the positive decision on providing financial support for non-investment projects and within 3 months for investment projects. If the contract is not signed within this timeframe, the financing decision shall no longer be valid.
 17. If the application has been rejected, the EPC shall inform the applicant in writing within 14 days of the date of the decision. A detailed explanation for rejection of the application shall be included in the correspondence. Rejected applications may be re-submitted, after corrections have been made, in the next application cycle.

Annex 2

Application Form for Financial Support for an Environmental Project (with instructions)

Draft

(to be completed by the applicant)

Project Code (completed by the EPC)

| |
|--|
| |
|--|

Type of Assistance
Requested:

| |
|--|
| Grant Loan interest subsidy Loan guarantee |
|--|

Project Type:

| |
|--|
| Air Pollution Control and Prevention Municipal Wastewater Management Municipal Solid Waste Disposal Waste Prevention and Treatment Industrial Wastewater Management Water Resource Protection Non-Investment Project |
|--|

Part I - General Information about Applicant and Project

| I-1 Applicant Information | | | |
|--|---|-----|-----|
| I-1.1 | Full Name of the applicant | | |
| I-1.2 | Address | | |
| I-1.3 | Telephone | | |
| I-1.4 | Fax | | |
| I-1.5 | Contact person | | |
| I-1.6 | Full names and functions of persons responsible for the project | | |
| I-1.7 | The establishment's form of property | | |
| I-1.8 | The principal areas of the applicant's activities | | |
| I-1.9 Has the applicant been charged with an environmental violation over the last 12 months? (If yes, explain the violation and indicate the dates) | | No | Yes |
| I-1.10 Does the applicant fully meet obligations to pay environmental charges and non-compliance fees ? | | Yes | No |
| I-2 Information about the project | | | |
| I-2.1 Project title | | | |
| | | | |
| I-2.2 Project goals | | | |
| | | | |

| I-2.3. Environmental effect of the project | | | | | |
|--|--|-----|----|----------------|-------------------------------------|
| 1 | Expected environmental (including public health) effect | | | | |
| 2 | Population affected by the environmental and health impact | | | | |
| 3 | Expected timeframe for achieving environmental effect | | | | |
| I-2.4 Project documentation (if answer is yes, please attach) | | Yes | No | Not applicable | Date or expected date of completion |
| 1. Technical design | | | | | |
| 2. Feasibility study, business plan or other economic and financial analysis | | | | | |
| 3. Environmental Impact Assessment | | | | | |
| 4. Project implementation schedule (for investment projects, use template below) | | | | | |
| 5. Construction permit | | | | | |
| 6. Other (please indicate): | | | | | |
| a. | | √ | | | |
| b. | | √ | | | |
| c. | | √ | | | |
| Who and when approved the project for implementation (please attach approval) | | | | | |
| I-2.5 Status of the ownership title to land and buildings (for investment projects only -- mark where appropriate) | | | | | |
| 1 | Settled | | | | |
| 2 | Not settled | | | | |
| 3 | Under settlement (describe status) | | | | |

| | | | |
|---|---|----|--|
| Description of critical factors affecting project implementation: | | | |
| | | | |
| I-2.6 Tender (contractor selection -- for investment projects only) | | | |
| Has tender been completed? | Yes | No | |
| If yes, please list all contractors (name of the firm and address) and attach contractor(s) selection report(s) | | | |
| 1. | | | |
| 2. | | | |
| 3. | | | |
| I-3 Proposed technology (for investment projects only -- describe) | | | |
| | | | |
| I-4 External opinions on the project (mark where appropriate and attach documentation) | | | |
| 1 | Positive attitude of authorities, local population and NGOs | | |
| 2 | Positive attitude of authorities, public protests | | |
| 3 | Public opinion not informed | | |
| 4 | Project known, attitudes neutral | | |

Investment Project Implementation Schedule (fill in appropriate cells)

| Activities | Month | | | | | | | | | |
|-------------------------------------|-------|---|---|---|---|---|---|-----|-----|-----|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | ... | ... | ... |
| Contracting | | | | | | | | | | |
| Engineering services | | | | | | | | | | |
| Purchase and/or preparation of land | | | | | | | | | | |
| Purchase of equipment | | | | | | | | | | |
| Purchase of materials and software | | | | | | | | | | |
| Construction and assembly works | | | | | | | | | | |
| Personnel training | | | | | | | | | | |
| Technical Testing | | | | | | | | | | |
| Start-up | | | | | | | | | | |

Part II - Financial Information

| | | | |
|---|--|--|--|
| II-1 | | | |
| II-1 | Total project budget (1000 RUR): | | |
| II-2 | Assistance (grant/credit) sought from the oblast budget (1000 RUR): | | |
| II-3. Proposed grant disbursement schedule | | | |
| | value of a tranche (in 1000 RUR) | Date of tranche disbursement (day, month, year) | What is to be financed from this Oblast tranche |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| II-4. Other sources of project financing | | | |
| | Other sources of project financing | amount (1000 RUR) | Status (if confirmed, attach written confirmation) |
| | 1. | | |
| | 2. | | |
| | 3. | | |
| | 4. | | |
| | 5. | | |
| | 6. | | |

II-5. Project Budget [1000 RUR]

| Sources of financing | Before 2002 | 2002 | 2003 | 2004 | following years | Total | Share [%] |
|-----------------------------|--------------------|-------------|-------------|-------------|------------------------|--------------|--------------------|
| Internal sources | | | | | | | |
| Rostov oblast budget | | | | | | | |
| Federal budget | | | | | | | |
| Municipal budget | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Total: | | | | | | | 100% |

II-6. Investment Project Financing Schedule [1000 RUR] – for grants only

| Activities | Costs to be Financed (Total/Budget Financing) | | | | | | | | | |
|-------------------------------------|--|----------|----------|----------|-------------------|----------------------------|----------|----------|----------|-------------------|
| | Year ... by quarter | | | | Total year | Year ... by quarter | | | | Total year |
| | 1 | 2 | 3 | 4 | | 1 | 2 | 3 | 4 | |
| Engineering services | | | | | | | | | | |
| Purchase and/or preparation of land | | | | | | | | | | |
| Purchase of equipment | | | | | | | | | | |
| Purchase of materials and software | | | | | | | | | | |
| Construction and assembly works | | | | | | | | | | |
| Personnel training | | | | | | | | | | |
| Technical testing | | | | | | | | | | |
| Start-up | | | | | | | | | | |

Part III - Environmental Data

- a) Air Pollution Control and Prevention**
- b) Municipal Wastewater Management**
- c) Municipal Solid Waste Disposal**
- d) Waste Prevention and Treatment**
- e) Industrial Wastewater Management**
- f) Water Resource Protection**
- g) Non-Investment Projects**

a) Air Pollution Control and Prevention

| III-1 Project type <i>(mark appropriate box in the second column)</i> | | |
|--|--|--|
| 1 | Energy efficiency | |
| 2 | Alternative energy sources | |
| 3 | Fuel conversion (coal to gas, coal to oil, oil to gas, or switching to cleaner solid fuels) | |
| 4 | Installation or modernization of end-of-pipe equipment | |
| 5 | Air pollution reduced due to introducing cleaner industrial process technology | |
| 6 | Other (please describe) | |
| III-2: Project location | | |
| 1 | Exact address | |
| 2 | Location of the environmental impact <i>(mark where appropriate)</i> | |
| | 1 | Downtown area and specially protected area |
| | 2 | Other densely-populated area |
| | 3 | Sparsely-populated area |
| III-3 Project description | | |
| 1 | Describe the current levels of emissions and resulting ambient concentrations. Describe current emission control equipment, technical description of a proposed project; justification of the proposed technologies <i>(attach additional sheets if necessary)</i> . | |

| III-4 Expected environmental effect | | | | | | |
|---|---|--|------------|--------------------|-------------------|-------------------|
| | | Pollutant | Unit | Before project (a) | After project (b) | Reduction (a)-(b) |
| | | Particulates | tons/ year | | | |
| | | SO ₂ | tons/ year | | | |
| | | CO | tons/ year | | | |
| | | CO ₂ | tons/ year | | | |
| | | NO _x | tons/ year | | | |
| | | Other pollutants | tons/ year | | | |
| | | 1. | | | | |
| | | 2. | | | | |
| | | 3. | | | | |
| | | 4. | | | | |
| | | 5. | | | | |
| | | 6. | | | | |
| III-5 Method of environmental monitoring (mark where appropriate) | | | | | | |
| | 1 | By direct emissions monitoring | | | | |
| | 2 | According to the technical specifications of equipment | | | | |
| | 3 | Other, e.g. input (fuel) characteristics (provide description) | | | | |
| III-6 Management of ash and other post-process products (mark where appropriate) | | | | | | |
| | 1 | No ash or post-process products | | | | |
| | 2 | By-products put to productive use (describe) | | | | |
| | 3 | Land-filling, wastewater | | | | |
| | 4 | Other (describe) | | | | |

b) Municipal Wastewater Management

| III-1 Project type | | <i>(mark appropriate box in the second column)</i> | | | |
|--|--|--|---------------|--------------------------|--------|
| 1 | Sewer (collector) construction and/or rehabilitation | | | | |
| 2 | Wastewater treatment plant construction and/or rehabilitation | | | | |
| | | Units | present state | after project completion | |
| III-2 Municipal wastewater | | | | | |
| 1 | Number of inhabitants in the area covered by the project | Persons | | | |
| 2 | Number of inhabitants connected to sewer system | Persons | | | |
| III-3 Industrial wastewater | | | | | |
| 1 | Population equivalent from industry (PE) ⁸ | Persons | | | |
| III-4 Stormwater | | | | | |
| 1 | Stormwater channeled into the sewer? | Yes / No | | | |
| III-5 Wastewater treatment (before and after the project) | | | | | |
| | | | Yes | No | Yes No |
| 1 | Is the sewerage system connected to the wastewater treatment plant? | | | | |
| 2 | Does the wastewater treatment quality comply with applicable technology standards? | | | | |
| 3 | What percentage of current wastewater treatment needs does the wastewater treatment plant cover? | | % | | % |
| III-6 Cost recovery | | | | | |
| 1 | User fee for wastewater treatment – industry | RUR / m ³ | | | |
| 2 | User fee for wastewater treatment – residential customers | RUR / m ³ | | | |
| | | Yes | No | Not known | |
| 3 | Does the accounting system separate water supply and wastewater treatment fees/costs? | | | | |
| 4 | If yes, do wastewater fees cover all operating costs of the sewerage and wastewater treatment system? | | | | |
| 5 | If no (3), do combined user fees cover all operating costs? | | | | |
| III-7 Location of the environmental impact | | | | | |
| 1 | Describe location of the environmental impact, providing information about water intakes located downstream from sewage outfall (distance in km), recreational and water sport facilities, fishing grounds, nature reserves, urban waterways, etc. | | | | |
| III-8 Management of sludges and other process by-products | | | | | |
| 1 | Describe the arrangements for managing wastewater treatment sludges and other process by-products. | | | | |

⁸ PE = (daily volume of wastewater [m³/day] x average BOD₅)/60

c) Municipal Solid Waste Disposal⁹

| | | Units | Present state | | After project completion | |
|---------------------------|--|----------------------|---------------|----|--------------------------|----|
| III-1. Solid waste | | | | | | |
| 1 | Volume of waste in the organized collection system | m ³ /year | | | | |
| 2 | Number of inhabitants included in the waste collection and disposal system | Persons | | | | |
| 3 | Landfill capacity | m ³ | | | | |
| 4 | Landfill gas utilization (<i>indicate appropriate</i>) | | Yes | No | Yes | No |
| III-2 | Landfill insulation (membrane, waterproofing) – <i>description</i> | | | | | |
| III-3 | Treatment of leachate – <i>description</i> | | | | | |

⁹ There is no separate form for a hazardous waste landfill. An appropriate tender is expected to be handled through a special request for proposals.

d) Waste Minimization and Treatment

| | | Unit | Before project | After project completion |
|--------------|---|----------------------|----------------|--------------------------|
| III-1 | | | | |
| 1 | Total waste generated | m ³ /year | | |
| 2 | Types of waste generated (<i>for hazardous waste, indicate classes and categories of waste</i>) a. b. c. d. e. | m ³ /year | | |
| 3 | Waste recycled | m ³ /year | | |
| 4 | Waste composted | m ³ /year | | |
| 5 | Waste incinerated | m ³ /year | | |
| 6 | Waste prevented due to introducing cleaner production technologies | m ³ /year | | |
| 7 | Waste reduced due to chemical or physical treatment | m ³ /year | | |
| III-2 | Description of technologies to be applied | | | |

e) Industrial Wastewater Management

| III-1 Project type | | (mark appropriate box in the second column) | | |
|--|--|---|-------------------|-------------------|
| 1 | End-of-pipe effluent treatment | | | |
| 2 | At-source effluent prevention due to introducing a cleaner process technology | | | |
| III-2 Location of the environmental impact | | | | |
| 1 | Describe location of the environmental impact, providing information about water intakes located downstream from effluent outfall (distance in km), recreational areas, fishing grounds, urban waterways, etc. | | | |
| III-3 Project description | | | | |
| 1 | Describe the current levels of effluents and resulting ambient water quality in the receiving water body. Describe current effluent control equipment, technical description of a proposed project; justification of the proposed technologies (<i>attach additional sheets if necessary</i>). | | | |
| III-4 Expected environmental effect | | | | |
| Pollutant | Unit | Before project (a) | After project (b) | Reduction (a)-(b) |
| Total Suspended Solids | tons/year | | | |
| BOD | tons/year | | | |
| COD | tons/year | | | |
| Nitrates | tons/year | | | |
| Phosphates | tons/year | | | |
| Oil and oil products | tons/year | | | |
| Toxic pollutants | tons/year | | | |
| 1. | | | | |
| 2. | | | | |
| 3. | | | | |
| 4. | | | | |
| 5. | | | | |
| 6. | | | | |
| 7. | | | | |

| III-5 Method of environmental monitoring <i>(mark where appropriate)</i> | | |
|---|--|--|
| 1 | By direct effluent monitoring | |
| 2 | According to the technical specifications of equipment | |
| 3 | Other (describe) | |
| III-6 Sludge management | | |
| 1 | Describe the arrangements for managing wastewater treatment sludges and other process by-products. | |

f) Water Resource Protection

| III-1 - Description of the project and technology | |
|--|--|
| | |
| III-2 | Detailed description of the environmental effect |

g) Non-Investment Projects

| III-1 | Project type <i>(mark appropriate box in the second column)</i> | |
|-------|---|--|
| 1 | Feasibility study | |
| 2 | Scientific research | |
| 3 | Development and implementation of monitoring systems | |
| 4 | Flora and fauna protection | |
| 5 | Environmental education | |
| 6 | Seminars and conferences | |
| 7 | Other | |
| III-2 | Project description: | |
| III-3 | Who and how will benefit from the project? | |
| III-4 | Description of factors justifying the project: | |
| III-5 | Description of expected environmental results: | |
| III-6 | Method by which the results of the project will be evaluated: | |

DECLARATION

I hereby declare that I am familiar with the legal consequences associated with submission or supporting of false documents or making unreliable claims in connection with my application for financing assistance from the Rostov Oblast budget.

I also declare that should the requested financial support be granted, it will be used exclusively toward the objectives of the project as described in this application, in accordance with the project implementation contract.

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