

**MAKING ENVIRONMENTAL FUNDS OPERATIONAL IN CEE/CIS:
OBSERVATIONS, LESSONS LEARNED AND SOME
IMPLICATIONS FOR NEW CONSERVATION TRUST FUNDS**

**TRAINING COURSE: CONSERVATION TRUST FUNDS
Vilm, November 9-13, 2005**

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Outline of presentation

- **A brief Overview of Environmental Funds in Economies in Transition;**
- **Observations and Lessons Learned, with a Focus on Project Cycle Management;**
- **Some Implications for new Conservation Trust Funds.**

A brief Overview of Environmental Funds in Economies in Transition

- **key characteristics of selected funds:**
 - **levels of revenue & expenditure**
 - **major sources of revenue**
 - **major fields of expenditure**
 - **forms of financial support**
 - **recipients**
 - **selected financing terms & conditions**

Key characteristics of selected CEE environmental funds. (Income and expenditures in mln EUR.)

	Bulgaria: National Trust Ecofund		Czech Republic: State Environmental Fund		Lithuania: Environmental Investment Fund	
	Income ¹	Expenditure	Income	Expenditure	Income	Expenditure
Total income/expenditure	3.68	1.46	107.20	63.34	-	-
1998	3.68	2.87	103.21	70.60	1.01	0.57
1999	0.41	1.82	101.24	81.00	3.24	0.83
2000	0.23	1.98	97.43	111.10	2.43	1.76
2001	0.11	1.36	110.53	133.30	3.14	1.34
2002	0.09	0.29	99.75	144.70	3.73	4.96
2003						
Major revenue sources in 2003 (with % of total revenues)	-Financial operations; interest on bank deposits (100%)		-Loan repayments with interest (35%) -Air charges & fines (19%) -Wastewater charges (16%) -Soil/land use and nature charges (11%) -Water use charges (10%) -Waste charges (5%)		-Pollution charges (73%) -Loan repayments with interest (27%)	
Major fields of expenditure in 2003 (with % of total annual environmental expenditures)	-Air (53%) -Water (32%) -Nature protection (12%)		-Water (58%) -Air (15%) -Waste (12%) -Renewable energy sources (10%) -Nature protection (6%)		-Waste management (49%) -Air (38%) -Wastewater treatment/sewerage (13%)	
Forms of support in 2003 (as a % of total annual environmental expenditures)	-Grants (100%)		-Grants (82%) -Soft-loans (15%) -Interest rate subsidies (3%)		-Grants (13%) -Interest free loans (82%) -Interest rate subsidies (5%)	
Recipients in 2003 ² (by share in annual environmental expenditures)	-municipal/local authorities (60%) -enterprises (28%) -state/public institutions (12%)		-municipal/local authorities (82%) -enterprises (6%)		-enterprises (100%)	
Selected financing terms and conditions ³	Fund may finance: -up to 30 % of the estimated total project cost for grants; -up to 15 % for commercially viable projects; -up to 70-80% of small biodiversity projects -		-Soft-loans for non-businesses: 2% interest, maturity ≤ 12 years, grace period ≤ 2 years. -Soft-loans for businesses: 5% interest, maturity ≤ 8 years, grace period ≤ 2 years. -Maximum interest rate for businesses: 90% of the base interest rate. -Interest subsidies on commercial loans are offered covering up to 5% of the commercial interest rate for ≤ 5 years.		<i>Soft-loans:</i> -Maximum for single investment 1.5 mln LTL. -Allocation period ≤ 5 years; repayment period ≤ 5 years, grace period ≤ 2 years. -Loans provided through authorized Credit Institutions which assume risk for non-repayment and provide ≥ 30% of the loan amount from their own resources. -Interest subsidies: ≤ 100% of interest for ≤ 3 years; maximum subsidy for a single project LTL 400 000. -Grants: ≤ 350,000 LTL over 3 years and 70 % of total investment costs.	

Key characteristics of selected CEE environmental funds. (Income and expenditures in mln EUR.)

	Poland:		Slovenia:	
	National Fund for Environmental Protection and Water Management		Environmental Development Fund	
Total income/expenditure	Income	Expenditure	Income	Expenditure
1998	374.85	246.14	21.57	13.33
1999	419.78	338.39	19.74	21.57
2000	391.20	295.19	24.40	28.56
2001	420.84	454.70	20.21	17.60
2002	380.53	329.17	25.03	19.09
2003	358.43	290.89	27.36	18.95
Major revenue sources in 2003 (with % of total revenues)	<ul style="list-style-type: none"> - Loan repayments with interest (62%) - Pollution charges and fines (23%) - Natural resource use (12%) - Financial operations; interest on bank deposits (2%) 		<ul style="list-style-type: none"> - Loan repayments (53%) - Interest on loans (21%) - Foreign loan (20%) - privatization (6%) 	
Major fields of expenditure in 2003 (with % of total annual environmental expenditures)	<ul style="list-style-type: none"> - Air (39%) - Water (31%) - Mining related activities (10%) - Waste (4%) 		<ul style="list-style-type: none"> - Water (41%) - Air (34%) - Waste (25%) 	
Forms of support in 2003 (as a % of total annual environmental expenditures)	<ul style="list-style-type: none"> - Soft-loans (53%) - Grants (42%) 		<ul style="list-style-type: none"> - Soft-loans (100%) 	
Recipients in 2003 (by share in annual environmental expenditures)	<ul style="list-style-type: none"> - enterprises (45%) - municipal/local authorities (43%) - state/public institutions (6%) 		<ul style="list-style-type: none"> - enterprises (59%) - private individuals (24%) - municipal/local authorities (16%) 	
Support for enterprises	% of annual exp.	Mln EUR	% of annual exp.	Mln EUR
1998	48	106.33	64	8.52
1999	55	177.75	82	17.69
2000	54	144.11	93	26.62
2001	57	245.98	88	15.56
2002	43	128.04	75	14.38
2003	45	119.32	59	11.25
Selected financing terms and conditions	<ul style="list-style-type: none"> - applicants cannot be in arrears on environmental fees/fines that would otherwise contribute to the Fund's revenue. - Fund loans, and credits extended by banks using Fund resources, shall not >80% of total investment costs. - For loans to companies \geq 51% owned by local authorities, the interest shall be 0.4 of the National Bank rediscount rate on bills of exchange. For other loans the interest shall be 0.5 of the rediscount rate. Interest on credits extended through credit lines is 0.4, but not less than 3% per year - Grace period: \leq 6 months for private enterprises - Subsidies for businesses are subject to the relevant laws on State Aid. 		<ul style="list-style-type: none"> - Soft-loans: may cover \leq 70% of eligible costs; repayment periods \leq 15 years; grace period \leq 2 years. - "Grant equivalent" of loans cannot exceed: when adapting to new environmental standards, 15% of eligible costs for large enterprises, 25% for SMEs, and; if exceeding environmental standards, or where no standards exist, 30% of eligible costs for large enterprises and 40% for SMEs. - Loans for environmental investments in enterprises: maximum eligible costs 70%; repayment period \leq 5 years; grace period \leq 2 years; interest - basic savings rate + 1.0%. (The base interest rate in 2003 was 6.2% while the Fund's interest rate in the same period ranged from 0.9% to 1.1%.) 	

Sources of additional information about funds in CEE/CIS

- **funds themselves (e.g. web sites, direct contacts);**
- **Ministries of Environment;**
- **OECD, World Bank, other IFIs and bilateral agencies.**

Observations and Lessons Learned

- **role and objectives of funds**
- **legal foundations and institutional structures**
- **revenues**
- **spending strategies and expenditures**
- **project appraisal and selection (“project cycle management”)**
- **monitoring, evaluation and reporting**

Role and Objectives of Funds

- **Funds should be considered and assessed in the “*big picture*” of environmental financing. Is there a need for subsidized environmental finance (a financing “gap”)? What is the nature/scale of the need? Do funds represent a best/good option for meeting that need?**
- **A fund’s role should be distinguished from that of other policy tools and should highlight the “*value-added*” of the institution. Funds are not “cure-alls” for environmental financing challenges and do not operate in a vacuum.**
- **A fund’s objectives should be: *appropriate* (i.e. ideally, funds should not replicate or substitute for budgetary functions); *realistic* (given available resources); and *defined clearly* enough to guide operations and allow performance to be measured.**

Legal Foundations and Institutional Structures

- **Legal basis should be well-grounded in existing national law and suited to given objectives. Resist options that appear attractive simply for the sake of expedience.**
- **Funds established by *parliamentary act* are generally stronger and more stable than those established by government decree.**
- **The legal foundation and institutional structure should ensure a high degree of *operational independence* (i.e. freedom from political interference in appraisal and selection of individual projects).**
- **The role for government bodies (e.g. MoE) is to set environmental priorities, key operational principles and selection criteria, and to monitor/evaluate performance – NOT to tell the Fund which projects to finance.**
- **A fund's supervisory body (i.e. Board) should include representatives of *major stakeholders*, including beneficiaries (e.g. municipalities, industry, NGOs); these interests should be *balanced* so that no single stakeholder can dictate decisions.**

Revenues

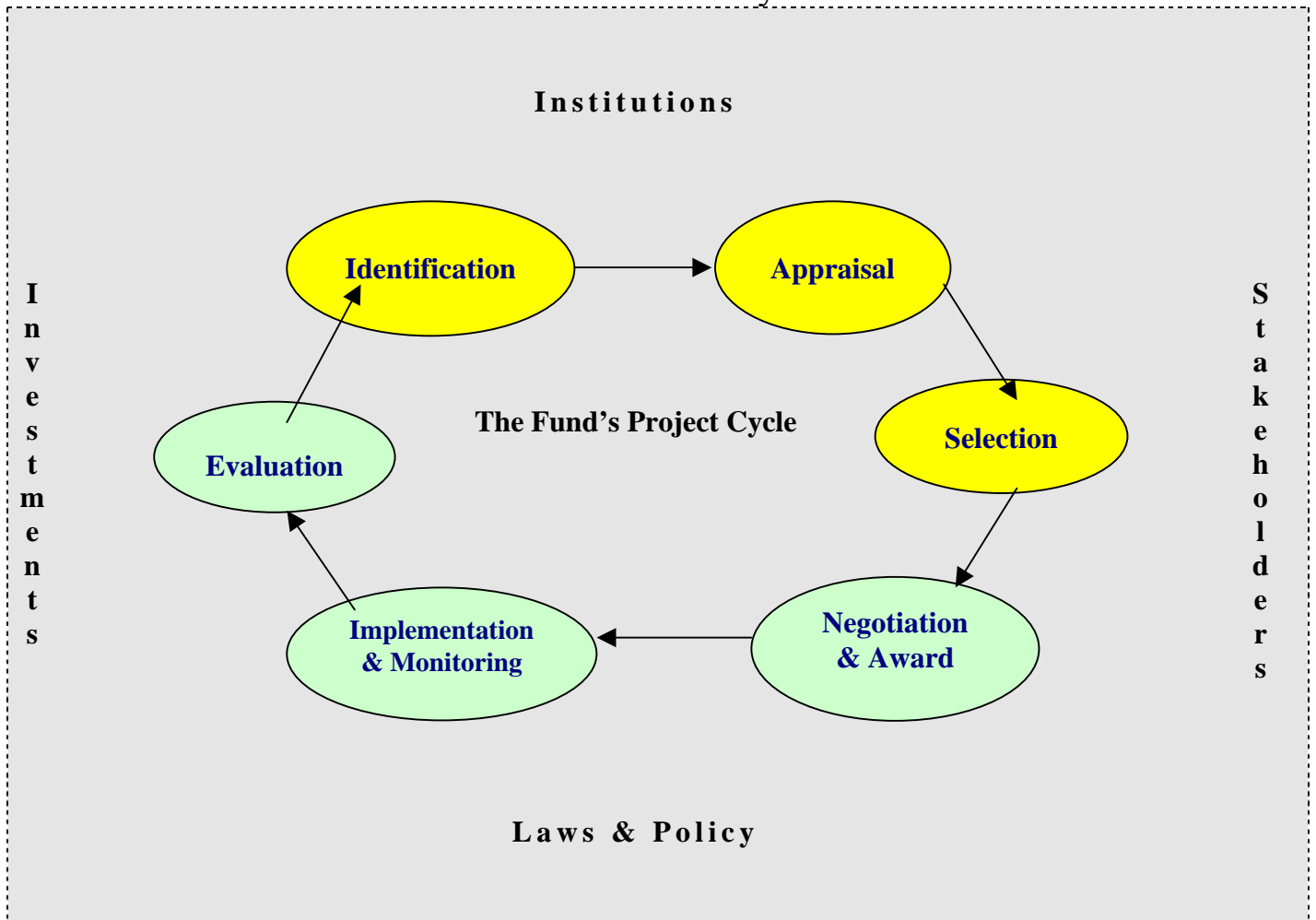
- **Should be: diversified, predictable, reliable over time, sufficient to support meaningful progress toward objectives and, ideally, mandated by legislation.**
- **Minimize earmarking (“recycling”) based on geographic region or source (though some level may be necessary to make politically acceptable).**
- **Loan provision as a means of “*revolving*” revenues is popular in CEE, but also raises a number of concerns (e.g. capacity, effect on leveraging).**
- **Foreign/international sources of finance typically entail significant, demanding rules, requirements and procedures.**

Basic Operating and Financing Principles of a Fund.

- **Throughout all its operations a Fund should strive to meet high standards of objectivity, accountability, transparency and efficiency.**
- **Whenever possible, a Fund should adopt *additionality*, *leveraging* and *co-financing* as fundamental financing principles.**
- **There is considerable international experience suggesting “good practice” in these areas.**

Spending Strategies/Expenditures

The Environmental Policy Framework



Spending Strategies/Expenditures

- **Priorities should be clearly consistent with National Strategies and Plans. If such programs do not provide adequate guidance for investments, Funds might clarify spending priorities through a participatory/consultative process involving stakeholders.**
- **Annual spending plans should give some indication of relative priorities among the field of eligible projects by specifying approximate amounts or proportions of finance available for each spending area.**
- **Targeted, competitive tenders for specific types of projects have proven effective for addressing certain environmental issues and making efficient use of Fund resources.**
- **Multi-year programs/strategies help ensure that cumulative effects of annual spending plans are coherent and mark significant progress toward objectives. They can also help the Fund to anticipate and plan for coming changes (e.g. in financing needs/opportunities).**

Project Appraisal and Selection

- **The most effective/efficient Funds have clearly defined, rigorous, transparent decision-making procedures, and clearly assigned responsibilities and accountability. Such procedures build domestic and international credibility.**
- **Cost-effectiveness should figure prominently as a key appraisal/selection criterion.**
- **A two-stage appraisal process can effectively “screen out” unqualified projects and save both the fund and applicant resources.**
- **In case of supporting investments/activities that generate income or substantial savings, Funds should develop and apply methodologies (i.e. assessment of IRR) to help them determine the project’s need for subsidized finance.**

Identifying Measures to be Financed by the Fund: General Eligibility Criteria and Application Procedures.

- **Guidelines governing the process of establishing these criteria should be developed, documented and followed.**
- **Suggested eligibility criteria: conformance with environmental priorities; legal status of applicant; conformance with financing principles and rules; strong local/national support for project; state of project preparation.**
- **Passive vs. more pro-active approaches to project identification.**
- **Application procedures: two-step process recommended.**
- **1) Applicant submits a brief “Project Information Form” (PIF), from which Fund determines whether project satisfies ALL eligibility criteria.**
- **2) If PIF is accepted, applicant invited to submit full “Project Application Form” (PAF), requiring detailed information about all aspects of the project, and then undergoes thorough appraisal by Fund.**
- **All rejected applicants given prompt written explanations.**

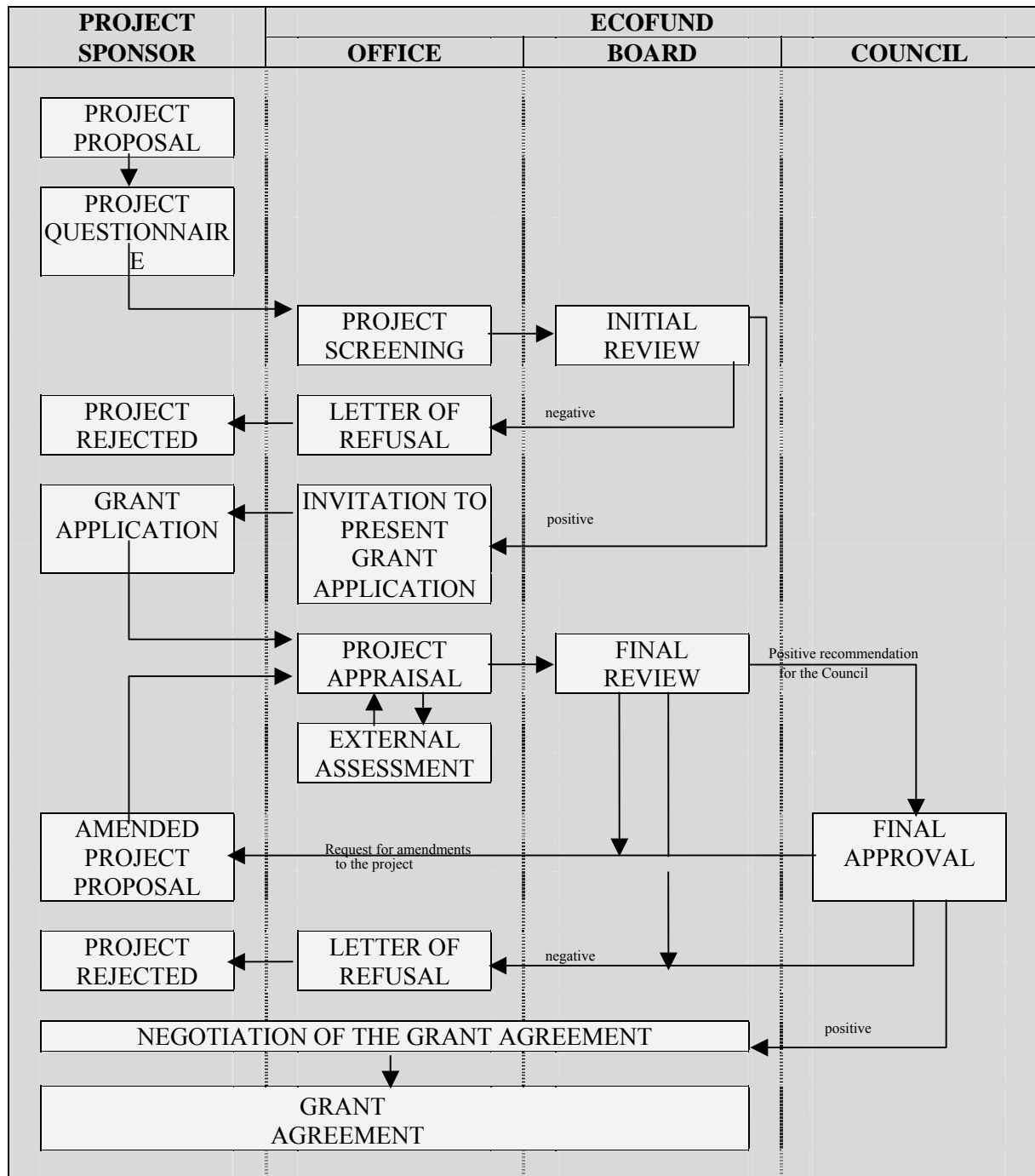
Project Appraisal and Ranking

- **Different appraisal criteria and information requirements for different types/categories of projects/activities.**
- **Applications grouped according to the environmental priority/issue and evaluated and ranked within their given grouping.**
- **Key appraisal criteria: cost/environmental effectiveness; technical design; financial feasibility; implementation feasibility.**
- **Depth and complexity of appraisal will vary according to: resources available (e.g. human, financial, information, time); demand for Fund resources; type/complexity of projects being appraised.**
- **Suggested methodological approach: numerical system for differential weighting of main criteria, scoring and ranking of project proposals.**
- **Allocating the “proper” weighting is a challenge: emphasis suggested on environmental impact and cost-effectiveness.**

Project Selection: Deciding which Measures will be Financed.

- **Final decision-making authority must be specified in Fund law and statutes; this will vary from fund to fund, country to country, depending on exact governance structure.**
- **The basis for approval of projects should be the expert, objective analysis of Fund staff (or other designated body).**
- **If there are more qualified (eligible) proposals submitted than available resources can finance, those qualified proposals should be ranked.**
- **Lists of project proposals ranked within each environmental priority/issue area.**
- **Lists of ranked projects should show “cut-off” point at which funds earmarked for that priority/issue would be exhausted.**
- **The Final Decision-Maker should have flexibility, albeit limited, to deviate from recommendations of the expert appraisers.**
- **If ranking list is deviated from, a written explanation should be provided by the Final Decision-Maker, and made publicly available.**
- **As a matter of routine, the list of projects approved for financing should be published by the Fund and made publicly available.**

The Polish EcoFund's project appraisal and selection process.



Monitoring, Evaluation and Reporting

- **Generally CEE funds have not given enough attention to monitoring implementation and post-project evaluations; both can be instrumental for learning from experience and assessing/improving fund performance.**
- **The most successful funds have very open, proactive policies toward public disclosure and dissemination of information (going beyond legal requirements for reporting to government, parliament, etc.).**

Some Implications for new Conservation Trust Funds

- **Try to develop a better understanding of the “big picture” for environmental financing in your country. National Environmental/Conservation Strategies should include *financing plans*. The OECD experience could be useful.**
- **Consider further, and clearly define, the objectives of the CTF; clarify its role, relationship and responsibilities vis-à-vis other policy tools and sources of finance, now and in future.**
- **Keep fund administrative structures light, especially if initially revenues will be relatively small. While maintaining independence of project appraisal and selection, take advantage of existing structures for logistical support and expertise; contract external expertise/services as needed.**

Some Implications for new Conservation Trust Funds

- **How will administrative costs of the funds be covered? A very important question, especially in the Fund's early days when revenues may be very limited.**
- **Funds should initially focus on providing grant support (i.e. not loans). As financing needs and demand are better understood, and as the funds gain experience as financial institutions, they could then consider other financing instruments.**
- **Continue/intensify investigation and development of other revenue options at local, national and international levels. Recognizing that the process will likely be long and difficult, formulate and promote persuasive arguments/information to help stimulate public and political acceptance of the Fund and revenue-raising measures.**