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Greening Public Budgets in Eastern Europe, Caucasus and Central Asia

Executive Summary

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EXECUTIVE SUMMARY

Public funding remains crucial for addressing environmental problems and, more broadly, promoting a greener model of development in Eastern Europe, Caucasus and Central Asia (EECCA) countries. Traditionally, however, the environmental sector in these countries has not been very effective in attracting domestic public financing. For instance, annual public environmental expenditure can be as low as one USD per capita.

Given the persistent constraints on public budgets in the region, and new challenges in accessing donor aid, environmental programmes are increasingly vulnerable to underfunding. In this context, the opportunities and obstacles for greening public budgets are analysed in ten countries.

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Public environmental expenditure remains crucial for addressing environmental problems and, more broadly, promoting a greener model of development in the countries of Eastern Europe, Caucasus and Central Asia (EECCA). Traditionally, however, the environmental sector in the EECCA countries has not been very effective in attracting domestic public financing. As the global economic and financial crisis imposes ever-tighter constraints on public budgets in the region, and as donors shift to new approaches of delivering aid via country systems, this sector becomes increasingly vulnerable to underfunding.

In this context, the OECD/EAP Task Force analysed the opportunities and obstacles for integrating environmental programmes into the medium-term expenditure frameworks (MTEFs) that a number of EECCA countries are introducing. In particular, the OECD/EAP Task Force undertook a regional survey, involving ten EECCA countries, namely: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Ukraine, and Uzbekistan. The key objective of this survey was to analyse whether the policy, legal, organisational and knowledge-related pre-conditions for achieving the financial sustainability of the environmental sector are in place in the participating countries.

In its most advanced form, MTEF is a tool that helps public authorities to structure the budget around programmes that are developed in line with explicit policy objectives and linked to specific outcomes, thus aiming to integrate policy, activity planning and annual budgets. Although adopted from a wider public sector reform perspective, this new way of planning is particularly suited to the needs of the environmental sector. As OECD practice testifies, the long-term nature of some environmental policies and infrastructure development can benefit from the stability created by MTEFs. More generally, financially sound environmental programmes stand a better chance of obtaining adequate funding. Even when there is a need for budget cuts, such programmes will suffer less damage, particularly if their economic rationale and policy relevance is well-documented.

Results obtained through the regional survey reveal significant progress in enacting reforms of public finance management (PFM) in EECCA countries. For instance, most countries in the region: consolidated government budgets, including *e.g.* extra-budgetary funds, public investment programmes, quasi-fiscal activities; introduced full classification of government revenues and expenditure by economic, functional, organisational and, to a certain extent, programme codes; improved medium-term macro-economic and fiscal projections, and imposed top-down expenditure ceilings on initial ministries' allocations. In order to better control the expenditure of public entities, EECCA countries created Chambers of Audits and treasury systems, and introduced single treasury accounts. Most countries also adopted modern, comprehensive Budget Codes which introduced, in one form or another, the use of MTEF and performance-oriented budgeting.

Since the introduction of MTEFs has often been driven by external financing conditionality, domestic political demand for MTEF use has not been high. As a result, MTEFs have been regularly developed by ministries, but they have generally not been discussed or endorsed by parliaments.

Information collected in the survey suggests that public environmental expenditure remains opaque and fragmented, and that the financial sustainability of the environmental sector is further eroding. In absolute terms, in the three pre-crisis years (2006-08) as well as in 2009, domestic public environmental expenditure generally increased. However, as a share of GDP and on a per capita basis, domestic public environmental expenditure were very low and decreasing in most of the countries. Based on existing information on public environmental expenditure, which is weak and should be improved, most public resources go to nature protection and conservation, and to water resources and waste management. Public environmental budgets, as a share of total government budgets in these countries, are very low and almost negligible, compared to the budgets of other social sectors (*e.g.* education, health). Public environmental investments are generally very low, with most environmental expenditure supporting current rather than investment expenditure.

The overall conclusion is that, due to limited capacity, the environmental sector benefits only marginally from PFM reforms in the EECCA countries:

- Despite the programmatic medium-term budgeting approach adopted by most of the EECCA countries, the programming process in the ministries of environment is generally weak and not sufficiently well understood.
- While many countries have invested significant resources in developing programmes as a basis for contributing to the MTEF process, these programmes are poorly costed and not supported by financial strategies, market studies or feasibility analyses. Only investment data are calculated, operating and maintenance costs are often not considered, as a result, programme estimates are not sufficiently robust.
- Programmes often lack clear and measurable environmental targets, performance indicators (particularly for the investment part) are not consistent across the years of programme implementation. Thus, the link between programme estimates and annual budget allocations is poor.
- Due to the lack of robust criteria, rules and procedures, and appropriate institutional arrangements, the management of investment projects (appraisal, selection and monitoring) is particularly weak.

The poor management of public environmental expenditure programmes further accentuates the negative effects of low allocation, and weakens the claim of environment ministries for maintaining or increasing their budget allocations. Thus many Environment Ministries are caught in a vicious circle of poor programming, declining budgetary allocations, and reduced impact. If not addressed, environment programmes will be further marginalised in public and donor finance programmes.

To address this challenge, the report makes the following major recommendations:

- On the side of the EECCA ministries of environment:
 - Develop and/or review medium-term public environmental expenditure programmes, using state-of-the-art analytical tools for economic and financial evaluation, in order to ensure feasibility, affordability and cost-effectiveness of the programmes submitted for inclusion in the MTEF process.
 - Increase capacity for designing and costing medium-term programmes, for managing public environmental expenditure, and for appraisal and financing of investment projects.
 - Improve the information and data base for preparing medium-term environmental programmes; cooperate with national statistical services to use internationally-recognised methodologies and environmental expenditure classifications.
 - Increase the transparency of public environmental expenditure, and accountability for results; develop and maintain a database of all public environmental expenditure programmes.
- On the side of the EECCA ministries of finance and governments as a whole:
 - Gradually implement PFM reforms, taking account of political demand and capacity within the government.
 - Continue the alignment of legal frameworks for PFM with good international practice, particularly as concerns budget (programme) classification.
 - Make further procedural adjustments to ensure fiscal discipline and increased transparency of public expenditure, *e.g.* by improving overall reporting and information disclosure requirements as well as by strengthening internal control and external auditing.
 - Develop government-wide guidelines for the preparation and costing of environmental programmes, and introduce cost-effectiveness as a criterion for project and programme appraisal, and for performance evaluation for all government agencies managing public expenditures for the environment.
- On the side of donors:
 - Further implement the Paris Declaration on Aid Effectiveness, particularly concerning the provision of information on the amounts and timing of aid, and by aligning donors' priorities with the EECCA countries' priorities.
 - Support capacity development, *e.g.* the development of specific skills in EECCA ministries of environment related to analysing costs and benefits of environmental policies and programmes, the better integration of environmental programmes into MTEFs, and the development of appropriate analytical tools.