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Capacity Screening of Oblast Environmental Funds in Ukraine

Final

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Definitions and abbreviations

DANCEE	Danish Cooperation for Environment in Eastern Europe. An organisation in the Danish Environmental Protection Agency (DEPA) which is responsible for the Danish assistance to safeguard environmental and natural resources in Eastern Europe.
MENR	Ministry of Environment and Natural Resources, Ukraine.
Oblast	Ukraine is administratively divided into 24 oblasts, 1 autonomous republic (Crimea) and the cities of Kyiv and Sevastopol.
OEF	Oblast Environmental Fund.
Oblast Administration	The regional administrations in Ukraine that serve the Governors and the Regional Soviets.
REAP	Regional Environmental Action Plan.
Regional Soviets	The legislative assemblies at oblast level.
SDEP	State Departments for Environmental Protection. It is the central State management body for environment in each of the 24 oblasts.
UAH	Ukrainian hryvnia (national currency unit).

1 Introduction

In its effort to streamline the environmental fund system, the Ukrainian Ministry of Environment and Natural Resources (henceforth: MENR) has asked for a capacity screening of oblast (regional)¹ environmental funds (henceforth: OEF) aimed at identifying a number of particularly promising funds that have the potential of becoming effective environmental financing institutions.

The capacity screening was conducted within the context of the DANCEE sponsored project “Strengthening of Environmental Funds at Regional Level in Ukraine” (2000-2002).² It was conducted jointly by MENR officials and COWI in the period of November 2000 – April 2001. The conclusions of the report ultimately rest with COWI.

This report presents the main findings. The detailed assessment of each of the funds along with methodological notes has been reported in the compendium entitled “Capacity Screening of Regional Environmental Funds in Ukraine – Compendium – Background Information” (2001).³

1.1 Screening methodology

The capacity screening has been designed to capture the internationally recognised standards for environmental fund operations, i.e. those developed by the EAP Task Force and OECD in the “St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy” (EAP Task Force, OECD, 1995)⁴ and the document “Environmental Financing in NIS: Integrating

¹ Throughout the report we will use the concept of “oblast level” as well as “regional level” to denote the administrative level which in the Ukrainian language is an “oblast”.

² The development objective of the project is to improve the environmental financing mechanisms in Ukraine by strengthening the environmental fund system. The project has seven components of which the capacity screening is the first. The others are: Preparation and dissemination of project management toolkits (component 2), various assistance to promising funds (component 3), training in the use of toolkits (component 4), preparation of investment projects (component 5), drafting of a Strategy Paper (component 6), and printing & dissemination of standards, etc. to environmental funds (component 7).

³ COWI thanks the EAP Task Force at the OECD for valuable comments to earlier versions of this report.

⁴ The main conclusions of the St. Petersburg Guidelines are presented in Appendix 3 to this report.

Public Environmental Expenditure Management and Public Finance in Transition Economies” (Peszko, 2000). Throughout the report the findings will therefore be related to these guidelines.

Definition of capacity

The capacity of a fund is defined to be composed of four individual capacities:

- 1 **Legal capacity:** The existence of legal texts outlining the purpose of funds, i.e. the extent to which the role and responsibility of the funds is made explicit and acknowledged by the relevant political-administrative system.
- 2 **Organisational capacity:** The organisational structure of the fund, clear division of work and responsibilities, office equipment, etc.
- 3 **Project management capacity:** The use of good project management practices and tools, priorities of spending, monitoring of projects, etc.
- 4 **Financial capacity:** The size of revenue channelled to the fund, share of revenue allocated to investment purposes, etc.

The capacity was measured via a simple ranking of the funds. Each fund received a score for each of the four capacities, ranging from 1 (low level of capacity) to 5 (high level of capacity). The funds have been ranked so that the *relatively* most promising fund scores high and the rest are being ranked accordingly. But in order to qualify as “promising” some basic criteria moreover should be fulfilled (see chapter 3).

We aim, thus, at a screening which shows the relative strength of the Ukrainian funds measured against each other. This will be done via a ranking of the funds (1-2-3-4, etc.). The screening shall also indicate the strength of the funds against international standards via the specific scoring that each fund receives for each of the four capacities. Only funds that operate in line with international standards will achieve the highest score (5) on each of the capacities.

Preparation, sending and collection of the questionnaire

Data was collected via a survey, containing more than 40 questions, which captured the four capacities.⁵ It was designed in dialogue with the MENR.

Prior to completion, the questionnaire was presented to representatives of the 27 OEFs (24 oblasts, Autonomous Republic of Crimea, cities of Kiev and Simferopol) at a seminar organised by the MENR at the end of November 2000. During the seminar the participants were introduced to the objectives of the assessment and given explanations how to fill in the data.

⁵ Please note that the survey did not contain questions addressing the collection rates. Since early 2000, collection of pollution charges has been the responsibility of the taxation authorities.

The questionnaires, which were sent to the regional funds in December 2000 with a cover letter signed by the then 1st Deputy Minister of MENR, Mr. Ruban, were collected in January 2001 by the MENR. The data were stored in an access database and supplementing documents were registered.

The response rate was as high as 23⁶ out of 27 funds replied.

Analyses of data and determination of promising funds

Based on answers given and materials submitted, each fund was given a score for each capacity. In order to ensure transparency, and following basic rules for conducting such analysis, the scoring was based on an explicit, qualitative argumentation that describes why and on what basis the researcher arrived at a given score. Hence, for each of the 23 funds there exists such documentation.⁷

During the analytic process it became obvious that answers given to questions addressing organisational capacity were of limited value, and it was decided to add the weight of 0.5 to the organisational capacity. The scoring for project management was also weighted. The funds have no legal obligations with respect to the use of management tools. Initiatives taken by some funds to introduce modern management practices show a good will for improvements; therefore it has been decided to give the weight of 1.5 to the project management capacity score.

The reader should bear in mind that with assessments like this one can never be fully “objective”, as the researcher has to weigh somehow incommensurable issues before (s)he reaches a given capacity score.

Data quality

The survey data quality turned out at some points to be of a mediocre quality.

In general too many standard answers were given. This, in particular, was the case for questions relating to organisational capacity where answers showed only little variations in the funds' organisational structure. The funds were merely pointing to existing legislation rather than answering the specific questions. It also turned out that most funds did not answer questions addressing staffing of the funds.

Verification of data

Two initiatives were taken to verify the data and to improve the validity of the conclusions. First, the main findings were presented to a number of people having insight into Ukrainian environmental funds⁸. They commented upon the

⁶ We received 24 questionnaires. However, one of these (from Lviv Oblast) contained hardly any information at all, and it was excluded from further analysis.

⁷ “Capacity Screening of Regional Environmental Funds in Ukraine – Compendium – Background Information”, DANCEE, 2001.

⁸ They are 1) Mr. Mikola Pilipchuk, Head of the Department of Environmental Economics in MENR; 2) Mr. Oleg Kulik, Chief expert in the Department of Environmental Economics in MENR; 3) Mr. Bogdan Pulawski, DANCEE adviser in Ukraine; 4) Mr. Vasilchenko, local DANCEE co-ordinator; 5) Mr. Vladimir Morozov, Chief of Laboratory in OAO

findings and confirmed them as reasonable. Second, a Ukrainian member of the project team, Mr. Vladimir Morozov, visited seven funds selected as potentially promising, in order to get a better understanding of actual performance of the funds. In conclusion, even if there are problems with the data quality, due to too standardised and imprecise answers to a number of questions, we consider the screening to leave a reasonably precise picture of the Ukrainian OEFs.

1.2 Main findings

The Ukrainian funds are very weak institutions

The OEFs form part of the public budgets at oblast (regional) level. They are administered by the State Departments for Environment Protection (SDEP) which are the central State management body for the environment in each of the 24 oblasts, Kyiv and Sevastopol.⁹

The funds do not have own office facilities and manpower capacity and there are no specific institutional structures associated with the funds. It appears difficult for the administrators at oblast level to separate environmental funds activities from other activities.

Approximately half of the fund revenue is spent on non-investment projects and activities, some of which are not related to environmental protection.

Almost none of the funds have developed an overall financing strategy. The link between specific environmental priorities as laid down in e.g. Regional Environmental Action Plans (REAPs) and project eligibility criteria appear blurred or non-existing.

In sum, the project team is of the opinion that Ukrainian OEFs, with very few exceptions, do not fulfil most of the criteria and recommendations in the St. Petersburg Guidelines. In other words, the *raison d'être* of Ukrainian OEFs is not proven by this assessment.

UkrNTEK; 6) Mrs. Svetlana Kaltigina, TACIS co-ordinator for environmental projects. Please note that the persons mentioned are not responsible for the final conclusions drawn by COWI.

⁹ Each local State Department for Environment Protection functions as a local branch of the Ministry of Environment and Natural Resources (MENR). They are guided by instructions from the MENR for planning and applying environmental law within its territory and area of competence. The main tasks are to enforce Ukraine's environmental policy and protect the natural surroundings from the effects of pollution; to promote compliance in the respective oblast; to carry out inspections; to apply State policy on the use and control of soils, groundwater and surface waters, mineral deposits, atmosphere; and to draw up regional environmental protection programmes. In practice, they work closely together with the Oblast Administrations that finance part of their operation and maintenance cost. Hence, the State Departments of Environmental Protection are only formally subordinated to the MENR only.

However, it should be noted that due to taxation authorities now being responsible for collection of pollution charges, the funds revenues have been increasing very substantially these years. The necessity of developing efficient fund management systems becomes therefore even more obvious.

Promising funds in Donetsk, Zaporozie and Crimea

Promising funds shall be capable of dealing constructively and competently with international donors in the short and medium term, e.g. they shall be able to prepare and to co-finance investment projects. This is a wide-ranging ambition in Ukraine; hence the projects team has found it important to label funds as promising only if they have the will and the financial capacity to be the spearheads among Ukrainian OEFs.

The capacity screening shows that there are three promising funds: Donetsk OEF, Zaporozie OEF and Crimean Autonomous Republic EF. These three funds contributed with app. 34% to the total revenue of oblast environmental funds in the year 2000. They showed the best understanding of their role and objectives. Furthermore, they apply already a number of project management tools, albeit not of a quality and consistency that fulfil international standards. They are located in parts of Ukraine that suffer from severe environmental problems. Moreover, there are a number of potentially promising funds.

The project team recommends that the three promising funds be asked to take part in the subsequent training activities of the project (“Strengthening of Environmental Funds in Ukraine at Regional Level”). The project team also recommends that the group of potentially promising funds and other funds will be encouraged to use some of the specific project outputs (e.g. improved project cycle guidelines).

The biggest funds are located in the south and the east

The biggest funds, in financial terms, are located in regions with severe environmental problems, i.e. the Eastern and Central regions of Ukraine. None of the ten biggest environmental funds are located west of Kiev.

2 Capacity assessment

The purpose of this chapter is to present the results of the capacity assessment, i.e. to assess the Ukrainian OEFs in relation to their legal, organisational, project management, and financial capacity.

2.1 Legal capacity

Objectives of the funds

All funds¹⁰ stated that they have clearly formulated objectives. Most of them referred to the Statute of the fund as the relevant legal document where these objectives are specified. However, the Statute normally only describes the overall directions of financing and do not specify any priorities as to environmental sectors; hence the Statute does not make up a well-developed strategy. Six funds¹¹ have mentioned other documents than the Statute of the fund, e.g. REAPs, as the documents specifying their objectives.

Although all the funds¹² stated that there exist REAPs for the area that they cover, none of them included REAPs among the legal documents that *actually* govern their everyday activities or referred to them as the document specifying their project selection criteria. This indicates a lack of understanding of the importance of prioritising environmental investments in relation to specific environmental targets. This impression was further confirmed when the project team, during field visits to seven funds, learned that the funds often refer to a rather general, national document from 1996 when making priorities on project level (see also section 2.3).

Reporting obligations

The national “Law on the Budget System” regulates regional funds' reporting obligations. Some fund management functions are delegated by the Regional Soviets (i.e. regional legislative assemblies) to the Oblast Administrations' financial departments that carry out financing from the funds to the project holders. The financial departments have to report to the Regional Soviets on expenditures from the budget funds. Therefore, all funds have stated in the questionnaires that they report to the Regional Soviets or have mentioned the Regional

¹⁰ Except for Zitomir Oblast Environmental Fund

¹¹ Vinnitsa, Odessa, Kherson, Volin, Zaporozh'ye and Chernigov Oblast Funds

¹² Except for Sevastopol City Environmental Fund

Administration, as an intermediate in the financial reporting on expenditure of the budget funds.

Conclusions

- The funds' statutes outline principal directions of financing but do not specify priorities.
- Environmental plans, like REAPs, are not used by the funds as guidelines for prioritising. It, therefore, remains somehow unclear what are the guiding principles that steer the prioritisation between different environmental problems and different activities.

The conclusions related to St. Petersburg Guidelines

- Lack of clearly defined objectives meaning that expenditure is not targeted sufficiently precisely to meet environmental objectives.

2.2 Organisational capacity

The overall organisational structure of Ukrainian environmental funds is determined by the existing legislation of which the following should be highlighted:

- The funds were established pursuant to the law "On Environmental Protection" (1991), which is one of 15 main environmental laws in Ukraine. Following an amendment to the law "On National Budget of Ukraine for 1998" and "On Modifications of the Law of Ukraine On Environmental Protection", the funds were consolidated into the national, regional and local budgets with effect at the beginning of 1999. They all had to be re-registered, which means that in their current form the Ukrainian environmental funds date back to 1998. As a consequence of the law amendments in 1998, the funds have no influence on revenue collection and cannot prevent that by decision of the regional legislative assembly, part of the revenue is used to cover other budget expenditures.
- In most cases, the State Departments for Environment Protection, which formally are subordinated the MENR, administrate the OEFs. In a few cases, the financial departments of the Regional Administrations administer the funds¹³.
- Within the framework of existing legislation, environmental funds do not exist as independent legal entities.

¹³ In the oblasts, where Regional Soviets directly and/or the Regional Administrations are in charge of the administration of OEFs, the State Department of Environment Protection at oblast level must provide them with the information on the oblast's environmental priorities.

The funds are not organisations

It does not make much sense to talk of the OEFs as organisational entities as they lack many of the typical characteristics of an organisation (employees, office facilities, clearly specified division of job, management board, etc.).

- **Staffing.** In practice there are no staff members that work solely with administration of OEFs within the particular administrative units that host the OEFs. The administration of environmental funds is one among many other obligations for the personnel in these units.
- **Management structures.** Most of the funds did not answer the questions related to their organisational structure, which is not surprising since formally this structure does not exist. The field visits to seven funds, even the most promising, showed that there is often a lack of clearly defined lines of responsibilities along with the lack of managerial autonomy over the selection of specific projects and beneficiaries.
- **Office facilities.** Environmental funds do not have any office facilities. According to all submitted questionnaires the office space and equipment either does not exist or is owned by the Regional Soviets, Regional Administrations or State Committees of Environmental Protection.
- **No administrative costs.** There are no administrative costs in the funds expenditures¹⁴. This reflects the fact that legally the funds only constitute a part of the regional budgets, and their administration is covered through the general budget items.
- **Awareness of funds.** Awareness of fund activities is in most cases to be achieved via communication between the fund and relevant stakeholders such as the environmental committees of the Regional Soviets, and relevant industrial enterprises. Furthermore, it is mandatory to publish the official decrees of Regional Soviets and Regional Administrations in the regional mass media, which means that from time to time, the funds activities are brought to public attention. In addition, half of the funds publish annual reports on their activities. In most cases they only include financial reporting on the funds' expenditures, more seldom names and titles of the projects. The selection process and priorities are normally not described in annual reports.

The most important index characterising public awareness of the funds is probably the number of project applications submitted to the fund. Only seven funds received more than fifty project applications in 2000, cf. Table 2.1. Considering the scale of environmental problems in the country, and the general lack of financing possibilities, the number of applications indicates a rather low level of awareness of the OEFs.

¹⁴ Except for a minor amount mentioned by the Sumi Oblast Fund

Table 2.1 Overview of the number of received project applications

Name of the fund	No of project applications	
	1999	2000
Dnepropetrovsk OEF	112	171
Poltava OEF	101	108
Donetsk OEF	92	120
Zaporozie OEF	92	105
Sumy OEF	68	80
Kharkov OEF	56	72
Chernigov OEF	50	78

Conclusions

- The OEFs are not organisations in their own right but merely budget lines administered by, typically, the State Department of Environmental Protection in the oblast. They have no staffing and office facilities.
- In reality, therefore, it appears appropriate to talk of *the capacity of regional environmental administrations* to administer this particular budget line rather than to speak of the capacity of environmental funds.
- The awareness of the funds appears mediocre judged by the number of applications received by the funds and the content of the materials that are published by the funds. It is, therefore, to be questioned if the criteria for allocation of resources, e.g. criteria of selection of projects and beneficiaries qualified for subsidies, de facto are available to the general public.

The conclusions related to St. Petersburg Guidelines

The St. Petersburg Guidelines acknowledge that the term “environmental fund” can be used just to refer to a revenue stream earmarked for environmental protection. An environmental fund is not necessarily a specific institution. As such the Ukrainian OEFs are environmental funds. But organisationally they suffer in terms of:

- Lack of clearly defined lines of responsibility
- Lack of manpower and managerial autonomy
- Lack of transparency.

2.3 Project management capacity

Planning of revenues & expenditures

All funds are preparing annual revenue and expenditure plans. Law requires this. It is furthermore required that these plans shall be approved. The right to approve rests with the Regional Soviets, as they are overall responsible for the regional budgets which includes the budget for the OEFs, cf. Table 2.2.

Table 2.2 *Authorities approving the annual revenue & expenditures plans*

Name of authority	No of funds
Regional Soviets	15
Committees of Regional Soviets	2
Regional Administration	2
Committees of Regional Soviets and Regional Administration	1
Council of Ministers (Crimea)	1
City Administration (Kiev)	1
City Soviet (Sevastopol)	1

Projects identification and selection procedure

The degree to which regional funds use different project management tools varies a lot, according to the survey data.

According to the survey data most of the funds have implemented a fixed procedure for project identification. A majority of the funds also use a standard project application form, and a standardised project evaluation procedure, while approximately one-third of the funds furthermore applies standard project eligibility criteria and standard initial assessment forms.

However, the visits to the seven potentially promising funds showed that the funds in fact often referred to highly general documents which specify the overall objectives and priorities with regard to environmental projects¹⁵ rather than specific practices related to the procedure of project identification. Therefore, Table 2.3 below tends to present the situation as more promising than is actually the case.

Table 2.3 *Use of project management tools*

Name of the standard tool/procedure	No of funds using the tool
Fixed procedure for project identification	17
Standard project application form	16
Fixed project evaluation procedure	15
Standard project eligibility criteria	11
Standard initial assessment forms (used by applicants)	8

¹⁵ Often the funds refer to "The List of Environmental Protection Activities", No 1147, 17.09.1996, where environmental priorities are specified at national level.

In 1999, the MENR provided the funds with a standard project application form¹⁶ but apparently, the funds do not use it.

This leaves the impression that most of the funds do not apply stringent project management practices (despite opposite information given in the survey), and this is not in line with the recommendations given with regard to programming of institutions managing public environmental expenditure. Such recommendations strongly call for environmental funds to have clear programmes and a set of rules that regulate investment decisions (Peszko, 2000). Programmes furthermore should have "SMARTT" objectives (specific, measurable, agreed, realistic, time bound, tough). We have seen little evidence that such practice and thinking are applied by the funds.

Conclusions

- The Regional Soviets are ultimately responsible for the approval of the funds' annual revenue and expenditure plans when they accept the overall regional budget. Decision-making at project level appears blurred.
- Many of the funds have stated that they use management tools for project identification and use project evaluation criteria. The field visits to some of the funds, however, showed that in many cases the answers given in the questionnaire were not true; hence this finding is highly uncertain.

The conclusions related to St. Petersburg Guidelines

- Lack of an overall financing strategy (programming)
- Lack of clear and explicit operating procedures for evaluating and selecting projects
- Lack of well-designed programme for investment projects
- Lack of proper project cycles to ensure cost-effective use of resources.

2.4 Financial capacity

Revenues¹⁷

Annual revenues for the Ukrainian environmental funds at oblast level have shown a stable increase during recent years, even when corrected for inflation.¹⁸ There are two main reasons for this; both of them are institutional.

¹⁶ The order of MENR "On planning and financing environmental protection activities from the National Fund" No 252, 29.10.1999, included a standard application form. This form has not been mentioned by the funds in the questionnaire.

¹⁷ The survey showed a substantial difference between the survey data and the annual revenues of the OEFs as stated in the Annual Report of the National Environmental Protection Fund (MENR, 2000). This reflects a general lack of transparency with regards to the fund's financial reporting. Data used in this report stem from the survey.

- First, since the beginning of the year 2000, the responsibility for the collection of pollution charges has been entrusted with the State Tax Administration and not the environmental authorities. The tax authorities in Ukraine are known to apply a tougher approach to collection of charges, and are better equipped to perform the collection function than the environmental authorities. Enterprises are more willing to pay the correct amount of charges, and collection rates have therefore gone up. In Donetsk Oblast, for instance, collection rate is up from below 15% in 1997 to over 30% in 2000 due to the fact that tax authorities are now responsible for the collection of pollution charges.
- Second, pursuant to the amendment of the “Environmental Protection Law” in 1998, and with effect from the beginning of 1999, the revenue collected from pollution charges is distributed differently among the state, oblast and local levels. 50% of the revenue generated in a given oblast is now channelled to the OEF compared to 20% before the change. The remaining 50% are distributed to national (30%) and local level (20%).

The total revenue has consequently increased and the relative amount hereof allocated to the OEFs has also increased, cf. figure below which shows that all OEFs in 2000 had total revenue of more than 37 million UAH.

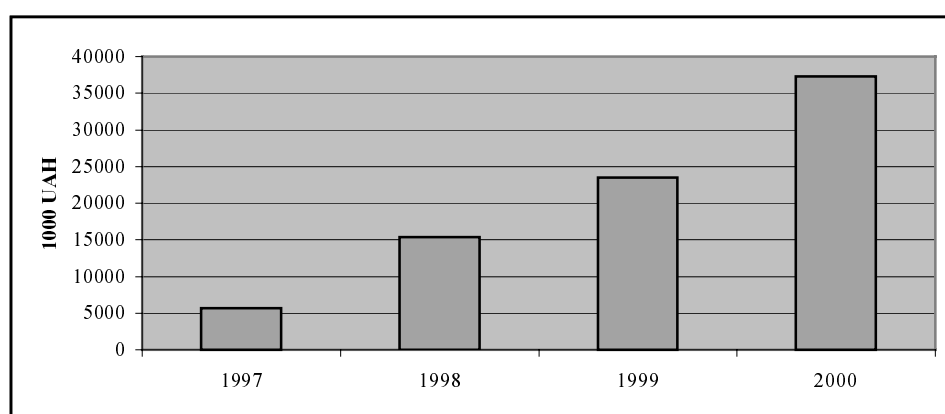


Figure 2.1 Annual revenue of the OEFs (1997-2000)

Sources of revenue

With effect from the beginning of 2000, environmental fines and claims were excluded from the possible sources of the funds' revenues (cf. “Law on Financing of Central Executive Authorities”). Being a part of the budget, environmental funds do not receive any budget allocation. Thus, pollution charges are by far the biggest source of revenue for the funds. During the reported period (1997 – 2000) contribution from pollution charges was app. 80-90%.

¹⁸ The exchange rate (annual average) for Ukrainian Hrynvia/US dollar was 1.86 in 1997, 2.45 in 1998, 4.13 in 1999, and 5.44 in 2000 (EBRD: *Transition Report 2001*, London, 2001, p. 209).

Mode of payment

The major part of the revenues is paid in cash, which is the only allowed mode of payment. According to the information provided by the funds, the cash share of revenue has fluctuated between 75 and 95% for the years 1997-2000. However, one big fund (Donetsk OEF) has reported that the cash share was as low as 30% in 1999 while the other funds have mentioned cash payment as the only mode of payment that year. We are not sure that Donetsk is an exceptional case in regard to the mode of payment; hence the aggregated level of cash payment for the funds for the period 1997-2000 might be lower.

The five biggest funds

The funds are very different with regard to their annual revenues. Over the last four years the five biggest funds have contributed between 64% and 73% to the total annual revenue of the 23 evaluated OEFs.

Table 2.4 Annual revenues for the five biggest funds (1000 UAH)¹⁹

Oblast	1997	1998	1999	2000
Total for the five biggest funds	3,837	11,132	16,132	23,956
Total for the 23 funds	5,711	15,402	23,504	37,262
Five funds in % of total	67	72	68	64

Geographical distribution of funds with the biggest revenue

The level of revenue of a given Fund reflects the economic potential of the region in which it is located and the scale of environmental problems in the area. It therefore comes as no surprise that the funds located in the most polluted and industrially developed areas, i.e. the Eastern and Central regions of Ukraine, have reported the highest annual revenues. None of the ten biggest environmental funds, in terms of revenue, are located west of Kiev.

¹⁹ For 1997: The OEFs in Donetsk, Zaporozie, Odessa, Poltava, and Khmelnytsk. For 1998: The OEFs in Donetsk, Kiev city, Zaporozie, Cherkasi, and Poltava. For 1999: The OEFs in Donetsk, Kiev city, Zaporozie, Dniepropetrovsk and Cherkasi. For 2000: The OEFs in Dniepropetrovsk, Donetsk, Zaporozie, Kiev city, and Cherkasi.

Map 2.1 Geographical distribution of the ten biggest funds in relation to annual revenues (total revenues for 1997-2000, 1000 UAH)



Share of investments projects

Ideally, environmental funds should allocate the main part of their revenue to the implementation of investment projects, and fund resources should not be used at all to cover running costs. In Ukraine, it appears that slightly more than half of the funds' total revenues have been spent on investment projects in recent years. The investment project share has been declining significantly since 1997.²⁰ The data available does not allow for an explanation of this development.

Table 2.5 Share of investments in the funds' expenditures (1000 UAH)

	1997	1998	1999	2000
Total investment projects	3,534	5,679	5,798	16,358
Total expenditures	5,149	7,666	10,978	29,594
% of investment projects	68	74	52	55

²⁰ It is worth mentioning that the share of investment projects in the structure of expenditures for the National Environmental Fund in 1999 was 35,4% i.e. is much lower than the percentage reported by the regional funds.

The structure of expenditures varies from fund to fund. Three funds solely finance investment projects, 6 funds focus entirely on non-investment projects while the other funds finance both types.

Distribution of expenditure by environmental sector

The OEFs attach the highest priority to the water and nature protection sectors, judged by the division of expenditure on environmental sectors, while least attention is focussed on air and waste, cf. Table 2.6.

Table 2.6 Expenditures in 1997-2000 by environmental sector²¹

Environmental sector	Expenditures (1000 UAH) in total for all OEFs	%	% for the Nat. Env. Protection Fund, planned for 2000
Air	4,426	7.6	6.6
Water protection and waste-water treatment	22,352	38.6	35.3
Waste	4,479	7.7	17.2
Nature protection	18,820	32	10.4
Education, public awareness, research and others	8,240	14.1	30.5
<i>Total expenditures</i>	<i>58,317</i>	<i>100</i>	<i>100</i>

Table 2.6 also contains information on the National Environmental Protection Fund. It appears e.g. that this fund allocates relatively more resources to public awareness than the OEFs but less to the category of nature protection.

Difference between revenues and expenditures and cash flow

Most funds have reported quite a substantial difference between the annual revenues and expenditures. This is evident from comparing, for instance, the total OEFs revenue of UAH 37 million in 2000 while the expenditures were totalling less than UAH 30 million for the same year (cf. Table 2.5). Explaining this, most funds referred to the balance on the funds' account at the end of the year. Most of those funds reported that more than 60% of the payment took place in the second half of the year and this should, apparently, explain the discrepancy. Discrepancy between revenue and expenditure has, however, been a prevailing feature for the whole period of 1997-2000, and thus cannot be explained with reference to budget cycles within a single year.

Only two funds²² have reported about transfer of money from environmental funds to other budget items. In light of the significant difference between revenue and expenditure for the whole period (1997-2000), it is more likely that

²¹ Please note that out of 23 submitted questionnaires, only 16 funds presented information on distribution of expenditures by environmental sectors

²² Odessa and Chernigov oblast environmental funds

transfer of resources from OEFs to non-environmental purposes is a common feature of many of the funds.

The gap between revenue and expenditure has fluctuated significantly. For the years 1997 to 2000, the annual expenditure for all OEFs was 90%, 50%, 47%, and 79% respectively compared to total revenue.

Conclusions

- Ukrainian OEFs are experiencing a very substantial increase in revenue size; from less than 6 million UAH in 1997 to more than 37 million UAH in 2000 (estimated).
- The funds are very different with regard to annual revenues. Over the last four years the five biggest funds have contributed between 64% and 73% to the total annual budget.
- For all the years (1997-2000) there is a gap between total revenue and total expenditure, which clearly indicates that resources are allocated to non-environmental purposes.
- The biggest funds are located in the southern and eastern regions of Ukraine, i.e. the areas that are most affected by pollution.
- In recent years approximately half of all OEFs' revenue is allocated to investment projects. The share of investment projects has been declining in the period 1997-2000.
- The water sector and nature protection represent the highest priority for the OEFs (judged by the distribution of expenditure by environmental sectors) while least attention is focussed on air and waste.

The conclusions related to St. Petersburg Guidelines

- Environmental fund resources should not be allocated to non-investment activities (e.g. running costs and equipment for environmental authorities, monitoring equipment, nature protection or international co-operation).
- At the time of increasing revenue allocated to the Ukrainian OEFs, the funds should strive to achieve legitimacy and not take their existence for granted. They should carefully consider the fact that there is not one single *ex-post* evaluation of environmental funds in the CEE/NIS countries that proves the funds to be of crucial importance for achievement of environmental results (Peszko, 2000).

3 Identification of promising funds

This chapter presents the ranking of the funds and identifies the most promising funds.

3.1 Ranking of funds

Ranking of funds based on the survey

Based on the survey, the funds have been ranked as shown in the table below.

Table 3.1 *Ranking of Ukrainian oblast environmental funds (based on survey)*

	Name of the fund	Capacity				Total score
		Legal	Org*	PM*	Financial	
1	Donetsk oblast	4	2	7.5	4	17.5
2	Zaporozie oblast	4	0.5	7.5	5	17
3	Aut. Republic of Crimea	4	1	6	4	15
4	Volin oblast	5	1	4.5	3	13.5
5	Cherkasi oblast	4	1	4.5	4	13.5
6	Sumi oblast	3	1.5	4.5	4	13
7	Herson oblast	4	1.5	3	4	12.5
8	Lugansk oblast	2	1	6	3	12
9	Zakarpacie oblast	3	0.5	4.5	4	12
10	Poltava oblast	3	0.5	6	2	11.5

* Organisational capacity weighted with 0,5. Project management capacity weighted with 1,5

In relation to the four capacities the following should be noted:

- The statutes of the funds only vaguely outline priorities. Except for a few OEFs (Volin OEF and to a lesser degree Donetsk OEF) they do not plan their activities in line with environmental plans, such as REAPs. This is the reason why few funds have been given the second highest score (4) and only one the highest score.
- The score for organisational capacity is low. This result follows from the fact that the funds are not organisations as such but merely budget lines without e.g. staff and office facilities.

- With regard to project management capacity, we found that most of the funds indicate the use of a number of project management tools, which should assist the funds in securing good project management. But based on field visits to a number of funds, we estimate that the de facto practices in most cases are of a moderate quality and are not routinely used. That is the reason why only two funds have been given the highest score.
- The funds' financial capacity has been improving, in the sense that in the period 1997 – 2000, the Funds have experienced a very significant increase of their revenue. However, the share of the funds' resources allocated to investment projects shows a downward tendency as it was down to 55% in the year 2000 (and 52% in 1999) compared to 72 % in 1998. Zaporozie OEF is the only fund that is given the highest score in terms of financial capacity. This fund is the second biggest fund in Ukraine. In addition, it allocates not less than 93% of its budget to investment projects, cf. Table 3.3.

It appears from Table 3.1 that three funds are evaluated as more promising than the rest. They are the Donetsk OEF, the Zaporozie OEF and the Environmental Fund of the Autonomous Republic of Crimea. The assessment is a relative assessment in the sense that these three funds are doing *better than* the other funds while not necessarily *good enough* if measured against international standards. In fact, none of the three funds achieved the highest score for all capacities, which indicates that they do not operate fully in accordance with international standards.

For further characteristics of these funds please see Section 3.2 below.

Ranking of funds based on field visits

The field visits to the seven highest-scoring funds, which took part after the initial analysis of the survey, gave no reason for changing the ranking of the three highest funds. The reason for not including more funds as promising is summarised in the table below.

Table 3.2 *Overview of four potential promising funds*

The fund	Reason for not being included as promising
Volin OEF	Many positive features. The priorities of the fund are e.g. based on various environmental programmes; the public awareness of the fund is high; an annual report is produced and the fund uses a standard application form and has developed procedures for project cycle management. The fund is located on the borders with Poland and Belarus. However, the fund has a very small financial basis.
Cherkasi OEF	No permanent responsible person. No project management procedures. Field visit revealed a number of wrong answers to the survey.
Sumi OEF	No project management procedures are in use. Field visit revealed a number of wrong answers to the survey.
Herson OEF	No project management procedures are in use. Tension between various administrative units having an interest in the fund. Field visit revealed a number of wrong answers to the survey.

3.2 The promising funds

Common characteristics of selected promising funds

The survey revealed that the Donetsk OEF, Zaporozie OEF and Crimea OEF are more promising than the rest. Besides scoring high when compared to other OEFs, the promising funds moreover fulfil the following basic criteria:

- They are located in an area with severe environmental problems.
- They have a high share of investment projects of total budget (75% as a minimum).
- They have shown interest in taking part in training activities aimed at improving their performance further.
- They are relatively big funds in financial terms (UAH 1,000,000 in revenue for 2000 as a minimum).

Table 3.3 Overview of the three selected funds

	Donetsk	Zaporozie	Crimean
Location	South-east; the most industrialised area of Ukraine	South-east; one of the most industrialised area of Ukraine.	South
Share of investment project of total budget (1997-2000)	80%	93%	75%
Revenue, 2000 (1000 UAH)	5,900	5,200	1,300
In percentage of the total for all OEFs	16%	14%	4%

Other main features of the funds identified as most promising are:

- **Donetsk OEF** is a well-functioning fund that actively seeks to apply project cycle management guidelines. The fund has a significant financial basis. It prepares annual reports and has a competent personnel. Environmental funds in the oblast (including local funds) are estimated to contribute 24% of the total environmental investments in the oblast (year 2000). The enterprise share is 76%.²³
- **Zaporozie OEF** has a high share of investment projects. Expenditures correspond to priorities as described in four environmental programmes. The fund has a significant financial basis. It receives many applications. Much attention is devoted to the protection of the Dnipro River, which is the prime drinking water source within the oblast. The environmental investments within the oblast for the year 2000 are shared between the enterprises' own resources (86%), the OEF (9%) and local funds (5%).²⁴
- **The environmental fund of the Crimean Autonomous Republic** has indicated possibilities for co-operation with Sevastopol City Fund. The fund has procedures for e.g. project identification and project assessment. Decisions are made according to the LEAP.

It should finally be noted that the environmental funds in Dnipropetrovsk, Kiev City, Cherkasi, Sevastopol, and Poltava all have a bigger revenue basis for

²³ Fund personnel provided this information in the spring of 2001.

²⁴ Fund personnel provided this information in the spring of 2001.

2000 than the fund in Crimea. They have, however, not been identified as promising due to various problems detected by the questionnaire.²⁵

²⁵ The two biggest funds, in financial terms, that have not been included as promising are Dnipropetrovsk and Kiev. In the survey there was no information on division between investment and non-investment projects from the Dnipropetrovsk fund, and not much supplementary documentation. Annual reports are not published. The Kiev City Fund does not distinguish between investment and non-investment projects and all revenues are being spent on one type of projects (nature protection).

Appendix 1 List of References

- EAP Task Force, Organisation for Economic Co-operation and Development, OECD (2000): *Performance Review of the Kazakh State Environmental Protection Fund and Review of Sources of Financing for Environmental Investments*.
- EAP Task Force, Organisation for Economic Co-operation and Development, OECD (1995): *St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy*, Paris, 1995.
- European Bank of Reconstruction and Development, EBRD (2001): *Transition Report 2001*, London, 2001
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- Peszko, G. (2000): *Environmental Financing in NIS: Integrating Public Environmental Expenditure Management and Public Finance in Transition Economies*. Paper presented at the Second Workshop on Economic Instruments in the NIS, Fourth Meeting of NIS Environmental Financing Network, on 22-24 March, 2000, in Tashkent, Uzbekistan. Paris.
- United Nations, Economic Commission for Europe (2000): *Environmental Performance Review – Ukraine*.

Appendix 2 List of funds included in the survey

1. Autonomous Republic of Crimea Environmental fund
2. Cherkasi Oblast Environmental Fund
3. Chernigiv Oblast Environmental Fund
4. Chernovtsi Oblast Environmental Fund
5. Dniepropetrovsk Oblast Environmental Fund
6. Donetsk Oblast Environmental Fund
7. Ivano-Frankivsk Oblast Environmental Fund
8. Kharkiv Oblast Environmental Fund
9. Kherson Oblast Environmental Fund
10. Khmel'nitsk Oblast Environmental Fund
11. Kirovograd Oblast Environmental Fund
12. Kiyv City Environmental Fund
13. Kiyv Oblast Environmental Fund
14. Lugansk Oblast Environmental Fund
15. Lviv Oblast Environmental Fund
16. Mikolaev Oblast Environmental Fund
17. Odessa Oblast Environmental Fund
18. Poltava Oblast Environmental Fund
19. Rivno Oblast Environmental Fund
20. Sevastopol City Environmental Fund
21. Sumi Oblast Environmental Fund
22. Ternopil Oblast Environmental Fund
23. Vinnitsa Oblast Environmental Fund
24. Volin Oblast Environmental Fund
25. Zakarpatie Oblast Environmental Fund
26. Zaporozie Oblast Environmental Fund
27. Zitomir Oblast Environmental Fund

Appendix 3 Main conclusions of the St. Petersburg Guidelines

The text below has been adopted from the document: “Performance Review of the Kazakh State Environmental Protection Fund and Review of Sources of Financing for Environmental Investments”, August 2000.

- Environmental improvements in the region depend on co-ordinated efforts in three areas: policy reform; institutional strengthening; and financing. Financing cannot act as a substitute for the other two elements.
- In order to avoid or minimise the long-term economic inefficiencies inherent in earmarking of funds, expenditure should be targeted to meet environmental priorities and promote projects with large environmental benefits relative to their costs.
- Environmental funds should play a catalytic role in financing, ideally offering no more support for projects than is necessary and adapting to changing economic conditions.
- Financing for environmental investments increasingly should be based on private sources, and follow the guidelines of the *Polluter Pays Principle (PPP)*.
- Environmental funds should be used in conjunction with, and reinforce, other environmental policy instruments, such as administrative direct regulations or economic instruments.
- Environmental funds should develop an overall financing strategy, follow clear and explicit operating procedures for evaluating and selecting projects, adopt effective monitoring and evaluation practices, and make effective use of internal and external expertise to enhance administrative efficiency.
- Environmental funds should focus on addressing the specific market and institutional failures that hinder environmental investments.
- In general, fund money should only contribute to the capital cost of projects, not the operational costs.
- For investment projects, funds should have well-designed programme and project cycles to ensure the cost-effective use of resources.
- Environmental funds must not compete with emerging financial markets but should leverage financing from private sector enterprises and financial institutions for environmental investments.
- In designing and evaluating fund revenue mechanisms, environmental authorities should ensure environmental effectiveness, economic and administrative efficiency, equity and acceptability.
- Environmental funds should ensure transparency and should be accountable to government, parliaments, and the public for their actions.

Source: *St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy*, Organisation for Economic Co-operation and Development, Paris, 1995.