

ENVIRONMENTAL FUNDS

WHAT IS AN ENVIRONMENTAL FUND?

- **Example of Infrastructure Earmarking**
 - Earmarking of Revenue for Fund
 - Earmarking of Expenditures from Fund
- **Used by Almost All EU Accession Countries**
- **Other Examples:**
 - Highway Trust Funds; Dedicated Taxes for Infrastructure Renewal

ISSUES

- **Is Earmarking Desirable?**
- **Do Environmental Funds Crowd Out Market-Based Financing?**
- **EFs Designed as Transitional Instruments. Do They Go Out of Business?**

REVENUE EARMARKING

- **Central and E. European Funds Financed from Pollution Fines and Penalties**
--Principle: Polluter Pays
- **Highway Trust Funds: Dedicate Gasoline Tax**
--Principle: User Pays
- **Implication: EF Revenues Decline as Pollution Is Addressed**

EXPENDITURE EARMARKING

- **EF Revenues Dedicated for Environmental Projects**
- **Pressure for Internal Earmarking**
 - Biggest Polluters Pay Most, Claim Priority for EF Investment Subsidies
 - Consistent with Public Policy?
- **Both Municipalities and Firms Eligible. Earmark Shares?**

DO ENVIRONMENTAL FUNDS CROWD OUT MARKET DEVELOPMENT?

- **Most EFs Give Grants and Make Direct Subsidized Loans**
- **Retard Growth of Private Credit**
 - **Poor Collection Rates for Loans; Bad Precedent for Market**
 - **Firms and Municipalities Reluctant to Borrow at Market Rates, Wait for Subsidy**
 - **Often Unclear Which Types of Investments Eligible for Subsidy, Which Must Use Market Financing**

WELL-DESIGNED FUNDS LEVERAGE PRIVATE CREDIT

- **Poland: EF Subsidy Combined with Specialized “Environmental Bank” Lending at Market Rate**
- **Introduced Banks to Municipal Market**
- **Environmental Revolving Funds (US, Proposed in India) Combine EF Subsidy with Market-Rate Bond Issues for On-Lending**
- **Complement and Strengthen Private Credit Market**

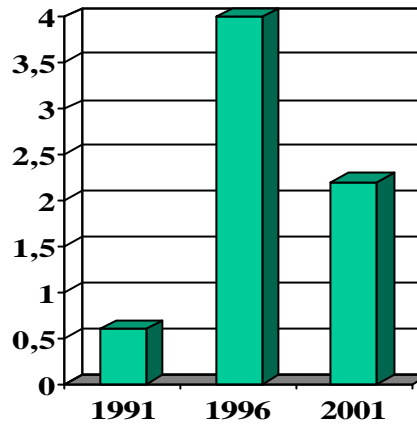
TRANSITIONAL ROLE OF ENVIRONMENTAL FUNDS

- **Designed to Catch Up with Worst Backlogs**
- **Then Be Integrated Into:**
 - General Credit Market for Lending**
 - General Budget Process for Investment Priority Setting**
- **Very Few Funds Have Been Phased Out**

Trends in local environmental investments in Poland (1)

Total municipal environmental investments:

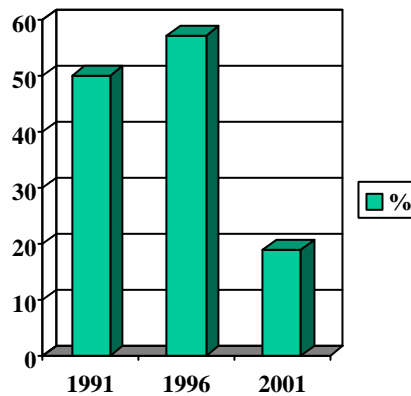
- 1991 – 0,6 bln zlotys
- 1996 – 4,0 bln zlotys
- 2001 – 2,2 bln zlotys



Trends in local environmental investments in Poland (2)

Municipal environmental expenditures in total local investments:

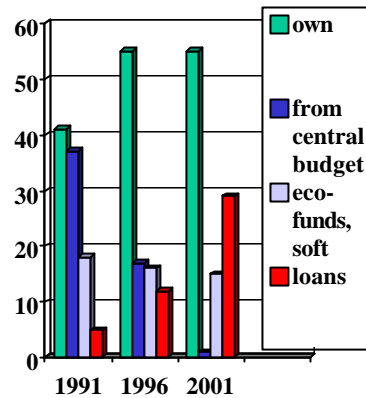
- 1991 – 50 %
- 1996 – 57 %
- 2001 – 19 %



Trends in local environmental investments in Poland (3)

Resources used by local authorities for financing investments (%):

	1991	1996	2001
own	41	55	55
central b.	37	17	1
eco-funds	18	16	15
Loans	5	12	29



Environmental effects of local investment

Area	1991	1996	2001
• Water supply systems (km)	93.200	168.900	218.100
• Sewage collecting nets (km)	26.500	35.900	56.600
• Towns with sewage treatment plants	467 / 830	683 / 864	818 / 884
• Biological treatment plants	302	583	796
• Biologically treated sewage (%)	37	56	83

LESSONS

- **Use EFs as Leverage for Developing Private Credit Market**
- **Avoid Direct Lending By EFs—This is a Specialized Activity, EF Track Record is Poor**
- **If Transitional—Have an Explicit Phase-Out Policy**
- **If Permanent—Have Transparent Rules for Subsidy Allocation and Complementing Market-Rate Credits**