



# Greening Public Budgets in Eastern Europe, Caucasus and Central Asia





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## *Foreword*

Over the last two decades, the countries of Eastern Europe, Caucasus and Central Asia (EECCA) have undergone significant political and economic reforms that, for most, resulted in sustained economic growth. However, the recent global financial and economic crisis that began at the end of 2008 hit the region hard, and virtually all countries suffered a sharp contraction of their economies. Amongst other things, the crisis revealed a multitude of structural weaknesses in the public financial systems of the EECCA countries that badly affected their economic performance. While the crisis has seriously affected EECCA economies, it also provides an opportunity for the governments of these countries to speed up the implementation of public finance reforms, and, in this context, to exploit opportunities to green their budgets in order to provide a more environmentally sustainable basis for further development.

This report aims to help EECCA countries' environmental administrations to harness the potential benefits of ongoing public finance reforms. A number of EECCA countries are introducing multi-year budgeting which aims to allocate resources in line with programmatic needs and priorities, to promote predictability and stability of funding, and to consolidate various sources of financing. The extent to which the environmental sector is being integrated into the medium-term budgetary processes in the EECCA countries is in the main focus of this report.

The analysis in this report is based on a regional survey that involved ten EECCA countries – namely Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Ukraine and Uzbekistan – and involved both ministries of environment and finance. The preliminary results of the survey were discussed at several different meetings (in October 2010 in Almaty, Kazakhstan; in November 2010, in Riga, Latvia; and most recently, in May 2011, in Berlin, Germany).

The report should be of interest to several different audiences: to ministries of environment, who need to enhance their knowledge and understanding of modern budgetary systems in order to ensure their programmes are well integrated into national programmes and budgets; to central planning (finance and economic affairs) ministries who are often not familiar with the rationale and potential benefits of environmental programmes; and donors who, despite moving to direct budget support, may wish to support partner countries ensure that the environment sector is not marginalised in the process of budget allocation.

The report was prepared within the framework of the EAP Task Force (Task Force for the Implementation of the Environmental Action Programme) and managed by Nelly Petkova. Different experts from the EECCA region have contributed to the report but particular thanks go to Suren Poghosyan (Armenia), Tatiana Plesco and Liuba Ivanchukova (Moldova) and Anastasia Lovidova (the Russian Federation). Angela Bularga (OECD) has been particularly helpful and supportive during project implementation. Eugene Mazur and Brendan Gillespie (OECD) have reviewed different drafts of the report and provided useful comments. Natalia Zugravu has helped with the processing of statistical data and Stanislav Kuld translated the

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The views expressed in this report are those of the authors and do not necessarily reflect those of the OECD or its member countries.

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## Executive Summary

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 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), and 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 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.



## *Abbreviations*

<b>CEE</b>	Central and Eastern Europe
<b>EAP TF</b>	Task Force for the Implementation of Environmental Action Programme for Central and Eastern Europe
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EEA</b>	European Environment Agency
<b>EECCA</b>	Eastern Europe, Caucasus and Central Asia
<b>FAO</b>	Food and Agriculture Organization
<b>FDI</b>	Foreign direct investment
<b>GDP</b>	Gross domestic product
<b>IMF</b>	International Monetary Fund
<b>MTEF</b>	Medium-term expenditure framework
<b>ODA</b>	Official development assistance
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>O&amp;M</b>	Operating and maintenance (costs)
<b>PFM</b>	Public financial management
<b>PPP</b>	Purchasing power parity
<b>PRSP</b>	Poverty Reduction Strategy Papers
<b>SEE</b>	South East Europe
<b>USD</b>	United States Dollar
<b>VAT</b>	Value-added tax
<b>WHO</b>	World Health Organization





## **Part I**

### **Cross-country analysis**



## *Chapter 1*

### **Setting the scene**

*This chapter sets the scene for the analysis of medium-term budgetary practices in the environmental sector in the countries of Eastern Europe, Caucasus and Central Asia (EECCA). This concerns, specifically, the shift to multi-year budgeting, based on medium-term expenditure frameworks (MTEFs). The chapter provides a brief overview of the main premises that underpin the MTEF approach and presents the methodology used to conduct this analysis.*

## Objectives and context of the analysis

Over the last two decades, the countries of Eastern Europe, Caucasus and Central Asia (EECCA) have undergone significant political and economic reforms. As part of this reform agenda, they have started modernising their public administration institutions and, more specifically, expenditure management practices, bringing them closer to international standards. Though impressive progress was achieved in this area, the recent global financial and economic crisis has revealed a multitude of remaining structural weaknesses in the public financial systems of the EECCA countries that badly affected their economic performance. The authorities reacted by adopting comprehensive anti-crisis policy response packages, often supported by the International Monetary Fund (IMF) and other international financial institutions. While this crisis is a real challenge to the EECCA economies, it also provides an opportunity for the governments to speed up the implementation of public finance reforms in order to provide a healthier basis for further development.

The EECCA region covers a group of 12 of the former Soviet Union republics. These include: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. After obtaining independence, these countries became collectively known as the Commonwealth of Independent States, later on as the Newly Independent States and most recently as EECCA. Despite the fact that over the last two decades these countries have developed at a different pace, there are still a number of factors (such as, among others, governance culture, economic structure, social values) that bring them closely together in a way which allows a “regional” analysis.

This report aims to help EECCA countries’ environmental administrations to harness the potential benefits of the on-going public finance reforms. In particular, this concerns the shift to multi-year budgeting, based on the so-called “medium-term expenditure frameworks” (MTEFs), such as the allocation of resources in line with programmatic needs and priorities, predictability and stability of funding, consolidation of various sources of financing, and, ultimately, a more effective use of public money for achieving environmental goals. More specifically, the extent to which the environmental sector in the EECCA countries is integrated into the medium-term budgetary processes as well as the implications of the progressive shift in aid modalities towards sectoral and general budget support are also analysed in the report. On this basis, the opportunities for, and limits to, achieving the financial sustainability of the public environmental programmes are identified.

### The medium-term expenditure framework (MTEF): An overview

At its heart, the MTEF approach seeks to link expenditure allocations to government policy priorities using a medium-term perspective (*i.e.* three to five year time horizon) to the budget planning process. Commonly viewed as a set of broad principles for sound budgeting, the MTEF-based budgeting is implemented in different ways in different institutional settings. This “institutional sensitivity” is crucial for the successful use of MTEFs. Defined in more technical terms,<sup>1</sup> a MTEF consists of: (i) a top-down allocation of the budget envelope; (ii) a bottom-up estimation of the current and medium-term costs of existing and new policies; and (iii) a process of matching costs with available resources in the context of the annual budget cycle.

In its most advanced form, a MTEF implies that the annual budget is structured around broad programmes which are defined in line with policy objectives and specific outcomes. Annual budgetary negotiations focus on new policies while the costs of on-going programmes are updated only on technical grounds. The update is based on the multi-year estimates prepared the previous years. These and other core elements of the MTEF methodology are described in Box 1.1.

### **Box 1.1. Benchmarks for an effective medium-term expenditure framework (MTEF)**

A **unified “whole-of-government” approach** that encompasses all sectors. In order to ensure a genuinely strategic resource allocation, the MTEF cannot be partial in coverage. Sectoral access to external funds may undermine this mechanism, principally because of the resource fragmentation and inefficiencies created by earmarked donor funding. Direct budget support is designed to help avoid such negative impacts.

A **“top-down” hard budget constraint consistent with macroeconomic sustainability** that limits spending levels over the medium-term. This should involve credible, realistic resource projections that are based on explicit and carefully considered macroeconomic assumptions. Mechanisms should exist to relieve administrative or political pressures for overoptimistic forecasts. The budget constraint should ideally be backed by political commitment from the executive and legislative branches and set in co-ordination with the various levels of government involved in the conduct of fiscal policy.

A **“top-down” set of strategic policy priorities** that, together with the hard budget constraint, drive and are reviewed during the strategic phase of budget preparation. Decisions made during this phase will guide the detailed preparation of budget and MTEF estimates.

**“Bottom-up” forward estimates of the costs of existing policies as well as new programmes and activities over the medium-term** supported by expenditure reviews. To have credible and robust estimates, the institution co-ordinating the MTEF process provides adequate guidance to the sectoral ministries on the preparation of programme/policy estimates (including, among others, various assumptions needed for calculating the programme estimates, such as GDP growth, inflation rate, demographic changes, discount rates to be used, etc.).

A **single nationally owned political process at the centre of government** that reconciles the bottom-up and top-down components, forcing policy priorities to be established within the overall resource constraint through resource allocation decisions. This includes the reallocation of resources from one sector to another (on the basis of transparent rules) as well as the allocation of any additional money or “fiscal space”<sup>2</sup> that arises for new policy initiatives.

A **strong and clear link between MTEF projections and the annual budget process**, so that multi-annual targets (duly updated for changes in the macroeconomic situation) set in the previous years form the basis upon which the budget is prepared. Ideally, there should be no distinction between the MTEF and the budget process: they should be one and the same thing.

A **focus on results (i.e. outputs and outcomes) rather than on financial inputs**. This implies that sector managers are given a more predictable flow of resources coupled with more discretion over detailed budget management. This is done on the basis that they have an informational advantage as to how best to spend public money. At the same time, they are held accountable for the delivery of results. In contrast with the “line item” approach, structuring the budget around programmes introduces an element of allocations contestability from year to year whereby sectors are not “entitled” anymore to their previous year’s allocation plus some small additional increment.

The **development of clear and robust procedures, rules and criteria for identifying and selecting projects** that will be financed from the respective programme is essential to ensuring the cost-effectiveness of such programmes.

*Source:* OECD (2009).

The credibility of this system lies in the government's capacity to estimate resources available for the public sector over several years, usually within a multi-year macroeconomic and fiscal policy framework. The development of sound macroeconomic and fiscal forecasts is crucial. While the estimation and forecasting process is mostly a technocratic exercise, there are a number of strategic and political decisions that depend on government choices which will shape the economy and thus the strength of the fiscal base of the country. Some of these include what structure of the economy will be supported by the government, the level of debt that will be incurred by the government or guaranteed by it and the overall taxation policy.

The MTEF cycle can either be rolling or periodical:

- **Rolling frameworks** are drawn up during budget preparation every year or every two years. Year 1 in the previous year's framework becomes the basis for the budget and a new year 3 is added (in case of 3-year frameworks). Thus, a MTEF cycle in a rolling framework will necessarily overlap with the previous and subsequent cycles by one or two years by design.
- By contrast, a **periodical framework** has cycles that run in sequence one after another. Specifically, a periodical MTEF is drawn up at the beginning of the period to which it applies and stays effective until that period has elapsed.

Both rolling and periodical frameworks may be revised in the middle of their lifetime. The time span of a MTEF may run for two, three, four, or five years, including the upcoming fiscal year. The most commonly used period is three years.

In general, there are four major types of medium-term budgeting,<sup>3</sup> including:

1. traditional fixed-term planning;
2. forecasting the economic composition of expenditure;<sup>4</sup>
3. forecasting the functional composition of expenditure;<sup>5</sup>
4. programmatic MTEF.

The traditional planning approach typically identifies in advance all major programmes and their funding over a fixed period of time – usually five years. What comes to mind are the typical command five year plans of the former Soviet Union economy. Experience shows that many of these plans were both economically and technically very well designed and impressive, internally consistent and complete in every detail except for the institutional context as to who will implement them, how, when and with what resources and under what incentives. These plans were close in spirit to a MTEF as they aimed to integrate the investment and operating and maintenance (O&M) costs. But the main problem was that the expenditure plans were not normally prepared under a revenue constraint. As such, they remained academic exercises only and would rarely get implemented as they were financially unrealistic and thus not credible. Besides, unlike current models of medium-term budgeting, the monitoring and evaluation systems were not effective, or they were practically missing, as those programmes were run by the same, or

associated, institutions that were formulating the plans, thus the results were not always objectively verifiable. Current models have, at least formally, decentralised some of the aspects of the budget cycle to different institutions, including parliaments. The greater role of parliaments in this process has also contributed to a more balanced model of overall budget cycle effectiveness.

Where they still exist, these top-down fixed plans could effectively be turned into a rolling continuous exercise. Still an important missing element in fixed-term planning is the lack of distinction between on-going programmes and new programmes which is the genuinely new element of the MTEF approach. This distinction is particularly important for the allocation of any new resources that may become available as, in principle, such additional resources should be predominantly assigned to new policy priorities.

Forecasting the economic composition of expenditure implies top-down rolling projections of aggregate expenditure for economic categories. Forecasting the functional composition of expenditure is similar to the previous one, in the sense that it implies top-down rolling projections of aggregate expenditure for economic categories but for each ministry and spending agency. In both cases, the projected expenditure is constrained by revenue forecasts based on medium-term estimates of various taxes and other revenues sources.

The forecasting MTEFs do not distinguish on-going from new programmes in the budget and rarely define performance indicators to monitor and evaluate programme implementation. They are important for fiscal sustainability and expenditure control, but do not, in themselves, improve resource allocation and expenditure efficiency. The purpose of a forecasting MTEF is to give an indication to budget entities of future resource availability and to send signals to private sector actors of future policy changes (*e.g.* in taxation policy) and guide their business decisions.

The last type of medium-term planning is the programmatic medium-term expenditure framework. Being the most advanced form of MTEF application, it implies that the MTEF is prepared and presented around programmes. This, however, does not preclude identifying expenditure by economic or functional categories but the starting point is the programmes that budgetary institutions should implement. The main characteristics of programmatic MTEFs are that they: (i) are revenue-constrained and prepared within top-down expenditure ceilings provided by the ministry of finance or the respective government office that takes care of the MTEF process; (ii) distinguish on-going and new programmes and more importantly define fiscal space for new programmes; and (iii) use performance indicators to monitor and evaluate programmes.

With its broad definition, the MTEF is often used to refer to various approaches to linking policy, planning and budgeting. On the one hand, the term may be used to simply refer to a forecasting MTEF, while on the other hand, it may refer to a programmatic MTEF. One important point to make is that the MTEF is a framework and not a fixed multi-year budget. Whether of the forecasting or programmatic variety, a MTEF serves to provide the medium-term perspective that is necessary for preparing a good annual budget – and should be discussed with and endorsed by the legislature – but must not be confused with a medium-term budget.

Experience from different countries shows that not all technical elements are in place at the start of a MTEF process, but making progress towards establishing them is a critical part of the MTEF development. While setting the medium-term fiscal targets and sector expenditure ceilings is usually a responsibility of the ministries of finance and/or economy,

estimating the costs of future policies, sector strategies and programmes lies with sectoral ministries. This is the **entry point** for the sectoral ministries in the MTEF process and depending on the quality of the financing strategies and programmes prepared by these ministries, the programme cost estimates could be effectively used as a basis for annual budget revisions and further allocations, as done in a number of OECD countries.

The MTEF model that is the most widespread today is largely based on the approach designed by Australia, a leader among OECD countries in reforms to control expenditure growth. Australia is the first country to have introduced the forward estimates approach to strengthen the link between government policy and expenditure programmes and improve the affordability of policies by combining projection methods with institutional arrangements to enforce the outcomes. As the Australian mechanism has worked well, many other OECD countries followed suit and introduced the forward estimate approach to their annual budgeting, in one form or other.

However, experience shows that the MTEF model can work well only when certain pre-conditions are in place. One of the problems with a MTEF is that often it has been pushed on countries without much understanding or sense of ownership. Most importantly, the MTEF needs a high level of political support for and commitment to the reforms and a champion in the government to guide and supervise the process. If there is no real demand for medium-term budgeting, the reform will remain on paper only and will be a waste of public resources.

Some important pre-conditions include:

- political discipline and accountability of a well-organised public service;
- interested and supportive legislature;
- the availability of a large pool of highly competent government economists, accountants, econometricians, sector specialists in both the ministry of finance and sectoral ministries;
- capacity to enforce a hard budget constraint;
- availability of reliable data on a timely basis;
- a sufficient degree of flexibility given to sectoral ministries and budget managers in both personnel and internal financial resource allocation;
- a diversified economy that provides a basis for predictable government revenue not dependent on external sources.

## The survey framework and methodology

The analysis in this report is based mostly on data and information provided by ten EECCA countries, namely Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Ukraine and Uzbekistan. Other sources have been used, as appropriate and these are cited. To collect relevant data and information for this analysis, the OECD designed a survey which was prepared along the main directions of public finance management reforms in the region, reflecting, in particular, the shift towards budgets based on MTEFs. The survey also asked specific questions related to environmental expenditure planning and management practices as well as donors' approaches to providing aid to the EECCA countries. The OECD started the survey process by developing an overall analytical framework. Based on international benchmarks, which



are not environment specific but are relevant to the whole public sector, the major questions to be addressed were identified for a small number of key areas of reform, which are as follows:

- **Policy drive behind budget allocation:** do strategic priorities drive budget preparation? Are they revisited during this process?
- **Intra-government coherence and fiscal discipline:** is there a unified “whole-of-government” approach that encompasses all sectors? Is a “top-down” hard budget constraint provided to sectoral ministries? Does this budget constraint ensure macroeconomic sustainability by limiting overall levels of spending over the medium-term?
- **Sectoral ownership:** is the “bottom-up” costing of policies and programmes applied?
- **Consistency of implementation:** does a strong and clear link between MTEF projections and the annual budget exist? Has a single political process been put in place to reconcile the bottom-up and top-down components of the resource allocation decisions?
- **Procedural soundness:** has the government developed a set of clear and robust procedures, rules and criteria for identifying and selecting projects that will be financed from medium-term programmes?
- **Availability and use of tools in support to evidence-based decisions:** is budget allocation based on expenditure reviews and other studies?
- **Transparency and accountability:** are accountability rules relying on monitoring and evaluation of results (*i.e.* outputs and outcomes) rather than on financial inputs?

The above “checklist” was then used to prepare the detailed survey questionnaire, which was discussed and agreed upon with the countries at a meeting in June 2009. Data collection was carried out by civil servants from the EECCA countries from both ministries of environment and ministries of finance. The draft report was then discussed at an expert meeting, held in November 2010 in Riga, Latvia and later on at the EAP Task Force annual meeting, held in May 2011 in Berlin, Germany. These discussions allowed the verification and updating of the initially provided data and information. Unless otherwise specified, the cut-off date for most of the financial data presented in the report is the end of 2009.

Given the EAP Task Force’s mandate to work mostly with environmental ministries, the survey, unfortunately, did not involve other sectoral ministries that may have environmentally-related programmes. Involving other government stakeholders would have clearly benefited the soundness of the analysis and should be envisaged in the future.

## Target audience and structure of the report

The report may be of interest to a diverse audience. Primarily, it responds to the needs of political staff and civil servants from ministries of environment who are willing to enhance their knowledge and understanding of modern budgetary systems in order to be able to effectively communicate with peers in central planning (finance and economic affairs) ministries. At the same time, the report aims to inform staff from the latter ministries, as well as other government and parliamentary officials about challenges faced

by the environmental sector. Another target group are donors who, despite moving to direct budget support, would like to ensure that the environment sector is not marginalised in the process of budget allocation. Generally, the report may be used as a basis for discussion and consensus building within the national governments and internationally on making public environmental expenditure planning and management an effective tool for promoting environmental improvements in the EECCA countries.

The report is divided into two parts, including a comparative analysis (Part I) and country fact sheets (Part II). Part I is divided into four major chapters. Chapter 2 briefly introduces the main features of the regional and international context in which the main public finance reforms have taken place, including in the environmental sector in the EECCA countries. Chapter 3 provides an overview of the public environmental finances in the surveyed countries. Chapter 4 focuses on reforms in the public finance management systems in the region while Chapter 5 discusses the specifics of expenditure and budget planning and management in the environmental sector. The report finishes with a summary of the major findings that emerge from the analysis and suggests a number of recommendations for improving medium-term budgetary practices, in general, and in the environmental sector in the EECCA region, in particular. It also offers some thoughts on how donors can help in this regard.

The overall conclusion emerging from the analysis is that implementing properly a MTEF is not an easy process. Experience from other countries shows that this is a learning-by-doing exercise. It takes time to institutionalise this approach which cannot happen without the concerted efforts of the entire public administration sector.

## Notes

1. World Bank (1998).
2. The term “fiscal space” is most commonly understood as the “room in a government’s budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy”. Such space is needed in order for governments to increase spending on national priority areas. A MTEF approach can help to clearly identify the available fiscal space thereby allowing policy priorities to be financed in a predictable manner. Fiscal space can be created by the phasing out of existing expenditures or through growth in total available resources, either in the form of additional revenue or aid inflows. Aid is less likely to be a source of genuine fiscal space than revenue because it is inherently unpredictable. The concept of fiscal space is often accompanied by the argument that the additional spending should be focused on areas that boost growth, thereby increasing future fiscal revenues and hence wholly or partially paying for itself. *Source:* Heller, P. (2005).
3. The discussion on the types of medium-term budgetary approaches largely follows Schiavo-Campo, S. (2008).

4. The economic composition of expenditure implies that government financial operations are structured according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments, and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.
5. The functional composition of expenditure implies that government activities and expenditures are structured according to their purpose, for instance: policing, defence, education, health, transportation, environmental protection. The United Nations standard functional classification, used in the preparation of national accounts and government financial statistics, distinguishes 14 major groups, 61 groups and 127 sub-groups.

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## Chapter 2

### The regional and international context

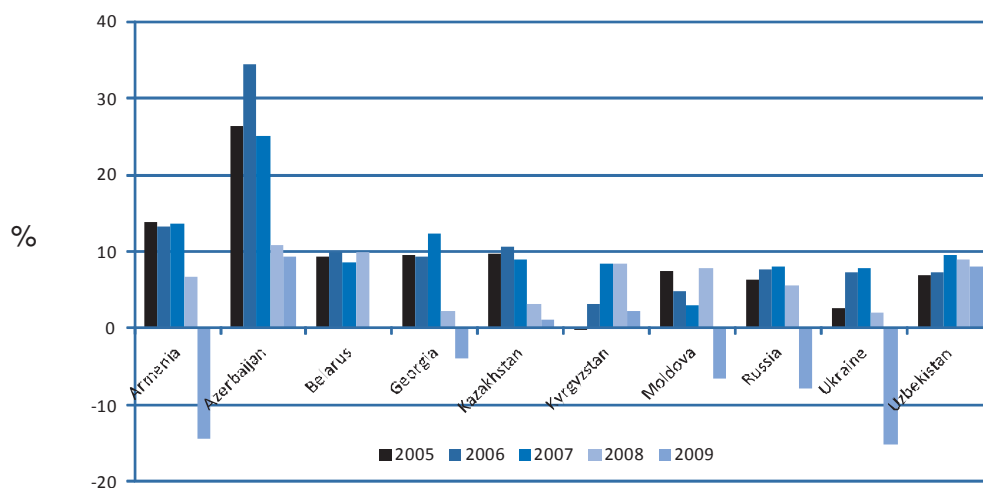
*This chapter looks at the major factors that shape the context in which the environmental administrations in the region of Eastern Europe, Caucasus and Central Asia (EECCA) operate and implement their policies. The chapter starts with a brief overview of the macroeconomic and environmental situation in the region, followed by a discussion of the key public finance reforms with a major focus on medium-term budgeting practices that have been progressively initiated in most of the countries over the past ten years. Finally, the chapter looks specifically at the governance structure of the environmental authorities in the EECCA countries and the demand for good practices for the preparation of robust multi-year expenditure programmes.*

## Macro-economic performance of the countries of Eastern Europe, Caucasus and Central Asia

In the countries of Eastern Europe, Caucasus and Central Asia (EECCA), the economic, social and environmental changes of the transition period have taken place in a very dynamic national and international context, most recently impacted by the world financial and economic crisis.

Between 2005 and 2007, the EECCA countries generally enjoyed a stable economic growth (see Figure 2.1). The growth was most spectacular in Azerbaijan, where the economy grew at an average rate of 28.6%, followed by Armenia with an average rate of 13.6%. The Kyrgyz Republic exhibited the lowest growth rate in this period – with an average rate of about 3.8%. As of 2009, according to the World Bank classification, two EECCA countries are classified as low-income economies (at USD 995 per capita or less), namely the Kyrgyz Republic and Tajikistan. Six countries, including Armenia, Georgia, Moldova, Turkmenistan, Ukraine and Uzbekistan, are classified as lower middle-income economies (at USD 996 – to 3 945 per capita) and four countries, Azerbaijan, Belarus, Kazakhstan and the Russian Federation, fall in the group of upper middle-income economies (at USD 3 946 to 12 195 per capita).

Figure 2.1. GDP growth in the EECCA countries, 2005-09



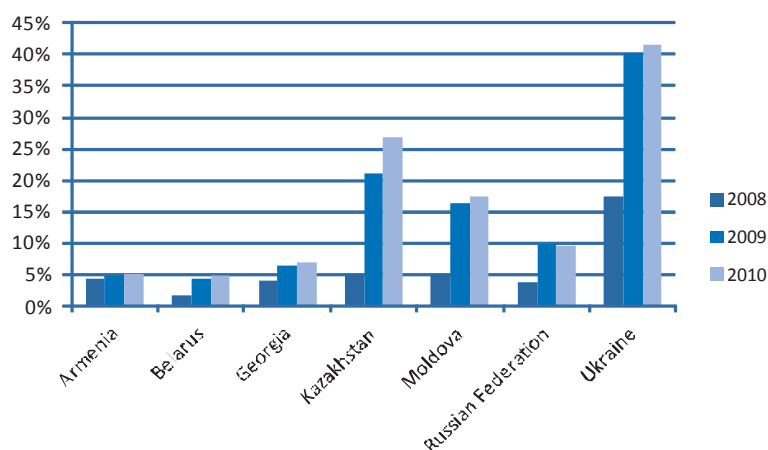
Source: World Bank, EBRD.

The EECCA countries were hit hard by the global economic and financial crisis that reached the region in September 2008. Armenia, Kazakhstan, the Russian Federation and Ukraine felt the crisis most severely among all. Economic activity contracted rapidly with large declines in industrial production. Bank credits began to contract significantly as well. This process of economic contraction continued until March 2009 when industrial output declines slowed or reversed and output-based growth started going up. Two of these countries put in place significant fiscal stimulus packages: Kazakhstan and the Russian Federation. The Russian package (5% of GDP, excluding support to the banking sector) provided support to local governments for social benefits but also for subsidies to industry. Kazakhstan's package amounted to 9.5% of GDP and it was used mainly to support industry and invest in infrastructure.<sup>1</sup>

The international policy response to the crisis in the EECCA region included large-scale balance-of-payments support for some of the countries. The International Monetary Fund (IMF) agreed programmes for of the countries in the region. For example, the IMF loan of USD 16.4 billion granted to Ukraine under a stand-by agreement was conditioned on the implementation of a comprehensive programme aimed at ensuring fiscal consolidation, structural reform and support for the financial system.

On the other hand, most of the Central Asian countries (except Kazakhstan) experienced a positive, albeit small, economic growth in 2009. One possible explanation for this situation is the low integration of these economies into the global financial system and the lack of “sophisticated” financial products in their banking sectors. Azerbaijan is somewhat a different case. Although the Azeri economy experienced a strong growth performance until 2008, both regionally and even globally, in 2009 already, the economy reflected a marked slow-down when compared with growth rates of over 20% annually during the previous three years. The European Bank for Reconstruction and Development (EBRD) envisaged modest growth for the region in 2010. Recovery was expected to be particularly difficult in Ukraine, slow and uncertain in Moldova, Kazakhstan and the Russian Federation, which suffer from a high number of bank non-performing loans<sup>2</sup> (see Figure 2.2) that remain to be written off or restructured and weak banking systems.

**Figure 2.2. Bank non-performing loans as a share of total gross loans (%)**

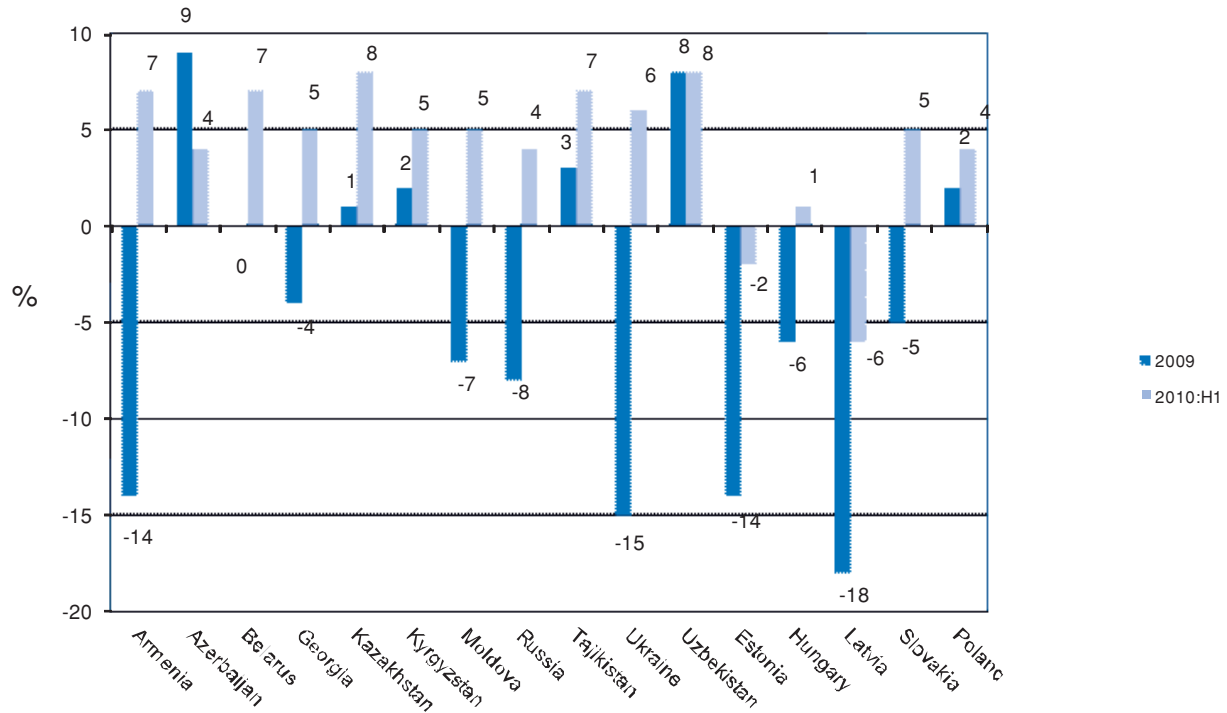


Source: World Bank database, International Monetary Fund, Global Financial Stability Report.

The most recent national data for 2009 and the first half of 2010 show that many of the EECCA economies are now converging back towards longer-term macroeconomic trends growth. Compared to the economies of some of the European Union’s new member states (such as Estonia, Hungary, Latvia, Poland, Slovakia), the EECCA countries are now generally exhibiting much more dynamic growth numbers than these economies. Nearly all EECCA economies are reporting GDP data for the first half of 2010 that suggest either promising recoveries from the recessions of 2009 (Armenia, Belarus, Georgia, Moldova, the Russian Federation, Ukraine), or acceleration (Kazakhstan, Tajikistan, Belarus) from the slow or stagnant growth recorded last year (Figure 2.3). The official data likewise indicate that Uzbekistan’s strong economic growth reported in 2009 continued in the first half of 2010.

**Figure 2.3. GDP growth rates in Eastern Europe, Caucasus and Central Asia and selected Central European countries**

2009, 2010 (first half, H1)



*Source:* For EECCA countries – CIS Statistical Committee, National Statistical Offices. 2010 data for Georgia and Moldova are for the first quarter. For the European Union countries – EUROSTAT. For Estonia and Latvia data are for the first quarter of 2010.

The EECCA countries range from very small to large economies (see Table 2.1): GDP was about USD 5-6 billion in the Kyrgyz Republic, Moldova and Tajikistan in 2009 and about USD 1 200 billion in the Russian Federation in the same year. In 2009, GDP per capita varied from about USD 700 in Tajikistan to about USD 9 000 in the Russian Federation, which is more than in some South-East European countries, such as Romania (USD 7 500) and Bulgaria (USD 6 423).



Table 2.1. Key macroeconomic indicators for the EECCA region (2009)

Countries	Pop., million inhabs. mid-2010	GDP, billion USD	GDP per capita USD	GDP real growth % change	General gov. tax revenue % of GDP	General gov. expend. % of GDP	General gov. balance, % of GDP	General gov. debt % of GDP	Gross fixed capital formation % of GDP	FDI inflows million USD	Domestic credit provided by banking sector, % of GDP	Inflation, consumer prices, annual average, % change
Armenia	3.2	8.7	2826	-14.4	16.4	28.8	-7.5	42.7	31	778	19.9	3.4
Azerbaijan	8.4	43	4899	9.3	16.7*	27.6	9.4	9.9	22	473	23.1	1.4
Belarus	9.7	49	5075	1.4	19.4	46.6	0.2	22.3	37	1884	34.6	12.9
Georgia	4.5	10.7	2449	-4.00	23.2	29.8	-7.8	34.7	14	658	33.2	1.7
Kazakhstan	15.7	115.3	7257	1.17	8.1	25.2	-2	10.9	29	13619	54.6	7.3
Kyrgyz Republic	5.1	5.9	860	2.3	15.4	37	-1.4	59.4	21	189	14**	6.9
Moldova	3.4	5.4	1516	-6.49	17.8	na	-5.7	24.4	26	128	41.6	-0.1
Russian Federation	142.2	1232	8684	-7.9	12.9	40.5	5.3	8.5	21	36751	33.8	11.7
Tajikistan	6.8	5	716	3.4	na	29.5	-5.2	41	17	16	27.5**	6.9
Turkmenistan	6.5	20	3904	8	na	27.5	7.8	45.3	11	1355	na	-2.7
Ukraine	46.6	113.6	2468	-15.1	16.4	49.3	-5.6	31.3	18	4816	88.5	15.9
Uzbekistan	26	32.1	1156	8.1	18.8	32.7	3.2	11.2	26	750	na	14.1

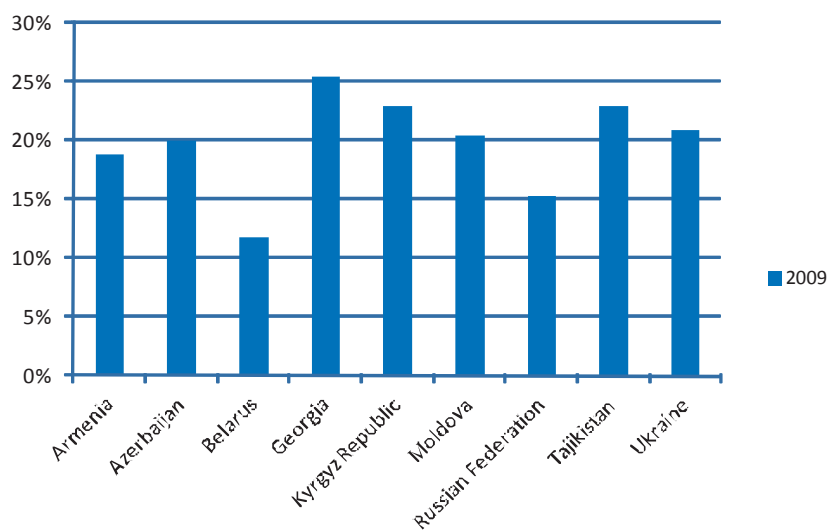
Note: \* – 2008 data; \*\* – 2007 data; n/a – data non available.

Source: IMF, World Bank, EBRD.

As a result of the crisis and contracted economies, the fiscal position of the EECCA governments has weakened by the generally low share of government tax revenue in GDP which has also substantially declined in 2009 in comparison with 2008. Armenia, Georgia, Moldova, Ukraine experienced significant government deficits in 2009. Workers' remittances declined as well. All this limits the public expenditure capacity at all levels of government. Domestic data for 2009 show that investments in most the EECCA economies have contracted significantly compared to previous years (see Figure 3.8 in Chapter 3).

The financial crisis highlighted serious weaknesses in the banking systems in many of the EECCA countries (*e.g.* reliance on foreign funding, fast credit growth with a great number of non-performing loans). The banking sector in the EECCA countries is still a small part of their economies. The volume of banking credit, as a share of GDP (*e.g.*, in Georgia, in 2009, it was about 30%), is still much lower than in some countries of Central and Eastern Europe (CEE) (in 2009, in Bulgaria it was 69.4% of GDP, Poland – 61.5%, Estonia – 106.2%) and several times smaller than in the “old” members of the European Union (*e.g.* France – 128.4%, UK – 228.9%). Only in Ukraine, was the level of domestic credit, in 2009, a par with the levels in some CEE countries. However, this rapid credit growth expansion in Ukraine could have possibly contributed to the subsequent liquidity problems in the sector. High lending rates (in most EECCA they are above 20%, see Figure 2.4) and spreads reflect the still fragile credit market in the region.

Figure 2.4. Lending interest rates (%), 2009



Source: World Bank database, International Monetary Fund, Global Financial Stability Report.

After a period of very high inflation at the beginning of the transition period, in 2001, half of the countries in the region slashed annual inflation to a single digit number. Since 2005, however, inflation has started growing again reaching more than 20% in 2008 in Azerbaijan, the Kyrgyz Republic, and Ukraine. Except in Belarus and the Russian Federation, in 2009, inflation in the other EECCA countries was brought back to one-digit levels. However, the EBRD expects that inflation in the region is likely to increase rather rapidly, driven by higher international food and fuel prices as well as large government spending packages.

Over the last couple of years, foreign direct investment (FDI) in the EECCA countries has been decreasing. In absolute terms and on a per capita basis, FDI in the EECCA region is still below FDI levels in the more advanced CEE transition countries. Only Georgia and Kazakhstan come close to the least advanced CEE economies. As a share of GDP, however, many of the EECCA countries have had higher levels of FDI compared to the CEE region in this period. Aggregated FDI data are presented in Table 2.2.

**Table 2.2. Foreign direct investment in the EECCA countries**

Net inflows recorded in the balance of payments

	Cumulative FDI inflows 1998-2008	Cumulative FDI inflows per capita, 1998-2008	FDI per capita, USD		FDI inflows, as % of GDP	
	<i>In USD million</i>	<i>USD</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>
Armenia	3257	1006	217	242	7.6	6.5
Azerbaijan	3229	384	-619	-66	-16.8	-1.2
Belarus	6708	694	183	222	3.9	3.6
Georgia	6643	1510	395	355	17.1	12.2
Kazakhstan	49501	3183	515	688	7.6	7.9
Kyrgyz Republic	1226	231	40	50	5.5	5.2
Moldova	2442	713	140	198	10.9	11.2
Russian Federation	43108	304	64	144	0.7	1.2
Tajikistan	1075	166	25	46	4.3	5.8
Turkmenistan	4748	730	124	126	6.3	4.3
Ukraine	40753	889	200	211	6.5	5.4
Uzbekistan	2858	103	26	26	3.2	2.5

Source: EBRD, 2009 Transition report.

### Environmental situation in the EECCA countries

The last 20 years have seen a general improvement in the environmental quality in the EECCA countries but this performance has happened at an uneven rate. These improvements, particularly at the beginning of the transition period, were partially attributed to reduced economic activity in the region. Compared to the OECD economies, the EECCA economies started the period with relatively low air emissions from mobile sources due to fewer vehicles and a smaller quantity of waste because of fewer consumer goods. On the other hand, however, the industrial emissions were very high and some of them were extremely toxic. In terms of natural resources, the record is also mixed.

The EECCA countries have had a particularly bad health record linked to environmental problems. Outdoor air pollution, smoke from solid fuel used in homes, exposure to lead and unsafe water and sanitation are considered among the most threatening environmental factors to people's health in the region. Table 2.3 shows the share of deaths attributed to environmental causes in several geographical regions. The Central Asian region has, by far, the worst indicators. For example, the contribution of indoor smoke, estimated for the countries in this region, can range from 1.6 and be as high as 5.2% of all deaths in different regions in Central Asia.

**Table 2.3. Share of deaths attributed to various environmental causes in different regions**

Country group	Outdoor air pollution	Indoor smoke from solid fuel	Exposure to lead	Unsafe water and sanitation
South East Europe	0.6 to 2.1	0.7 to 1.3	1.1 to 1.3	-
Central Asia	1.1. to 2.6	1.6 to 5.2	1.3 to 1.5	3.2 to 3.3
Other EECCA	1.2 to 1.4	1.3	1.1 to 1.2	-
Germany and UK	0.6	0	0	0

Source: World Health Organization (2005).

Note: “-” – No data available.

The EECCA region faces numerous acute environmental problems related to hazardous waste and land contamination, water quality and quantity, air pollution, solid waste management. What follows is a brief overview of the environmental situation in the EECCA region with a focus on the major problems that have drawn public attention over the years.

The EECCA situation with respect to hazardous waste, including from solid and liquid waste deposits, radioactive waste, mining or as a result of oil extraction and refining (and related water and soil contamination), is critical. Several inadequately protected uranium mining tailing dumps are of particular concern in the Kyrgyz Republic, Uzbekistan and Tajikistan. In Armenia, the management of tailings and other emissions is not adequate (*e.g.* a typical case is the Teghut open pit copper mine). In the Kyrgyz Republic, the indiscriminate use of chlor-organic pesticides has been identified as a serious health hazard in some regions. In the region of Osh, the pollution of groundwater, as a result of the use of pesticides, is a growing problem and is related to the significantly increased breast-cancer rates for women. Contaminated land in the Russian Federation, as a result of mining activities, generating tailings, ash and slag, is increasing by 7 000 hectares per year<sup>3</sup>. Remaining stocks of pesticides are still large (estimates show a total amount of dangerous pesticides of up to 14 000 tons in the country). Oil pollution is a major concern in the oil-rich countries of Azerbaijan, Kazakhstan and the Russian Federation. The legacy of Belarus and Ukraine with the Chernobyl disaster is well documented.

In many EECCA countries, the proportion of solid waste stored in poorly controlled sites and the amount of waste, including hazardous waste, are increasing. In Ukraine, for example, about 60% of toxic waste-deposited heavy metals, oil products, pesticides is still disposed of in landfills without treatment which increases the risks of environmental accidents.

In terms of water quality and quantity, the region has had a bad record as well. In Armenia, the lake Sevan is heavily contaminated by persistent organic pollutants. The environmental, social and economic catastrophe of the Aral Sea has caused a collapse of the fishery industry in the region and affected severely the health of local population. As a result of this disaster, the population has suffered from high levels of anaemia, miscarriages and pregnancy complications, thyroid problems, infectious diseases. Discharges of untreated wastewater and deterioration in drinking water pipes are seen as primary attributes of water contamination in the region. For example, water bodies in Kazakhstan are intensively polluted by the country’s mining, metallurgical and chemical industries as

well as city utilities. The most polluted of all are the Irtysh, Nura, Syr Darya rivers and the Balkash Lake.

The problems of outdoor air pollution are particularly acute in Ukraine and the Russian Federation. The result is a high number of premature deaths. For example, 2002 data on the Russian Federation on concentrations of total suspended particulates in urban locations from 98 cities with a combined population of 45 million indicated that the levels of particulate matter are several times above the Air Quality Guidelines levels of the World Health Organisation (WHO).

In terms of natural resources management, the region has suffered from important losses of biodiversity, declining marine environment, worsening quality of forest cover, to mention just a few. In addition, the declines in agricultural productivity have become an urgent matter. Some of the major causes for this decline are: acidification, soil erosion and salinity in deteriorating irrigation systems.

Food and Agriculture Organization (FAO) statistics show that since the start of the transition period, most EECCA countries have maintained or even increased their forest cover, except for Armenia and Kazakhstan. One particular challenge with regard to forest coverage is illegal logging. Illegal logging accounts for more than 10% of all loggings in Armenia, Azerbaijan, and Tajikistan. In the Far East of the Russian Federation, it accounts for around half of all loggings. These illegal and uncontrolled loggings often result in the loss of high value species and soil erosion.

In the agricultural sector, some of the main problems are related to soil erosion and increased salinity in many irrigated EECCA regions. As a result, soil fertility has declined and agricultural output production decreased. The share of irrigated agriculture affected by moderate to severe soil salinity,<sup>4</sup> for example, ranges from around 20% in Azerbaijan and Uzbekistan, 30% in Kazakhstan, the Russian Federation and Ukraine, to over 90% in Turkmenistan. These trends have important economic implications for these countries, as agricultural output represents a significant share in GDP. In the EECCA countries, it makes up to 18% of GDP, compared to 14% in South Eastern Europe, and 2.2% in the OECD countries. What is more important though is that the impacts of soil erosion are cumulative: initial damages from soil erosion may be small, but after 10-20 years the cumulative effect can be significant.

In 2007, the European Environmental Agency (EEA) reports that marine resources in the EECCA countries are in a poor state, with overfishing, poaching, eutrophication and industrial effluent, including oil spills, as the main causes of marine damage. One of the most telling examples of marine mismanagement in the region is the Caspian Sea. Catches of sturgeon, its key resource, have fallen dramatically over the past years (from 13 300 tonnes in 1990 to 800 tonnes in 2005) which has resulted in significant economic consequences for the region.

Solving these environmental problems and the associated economic and societal losses require significant resources, both public and private. How has the public sector in the EECCA countries coped with these environmental challenges is a discussion which we will continue in Chapter 3.

## Public finance reforms in the EECCA countries

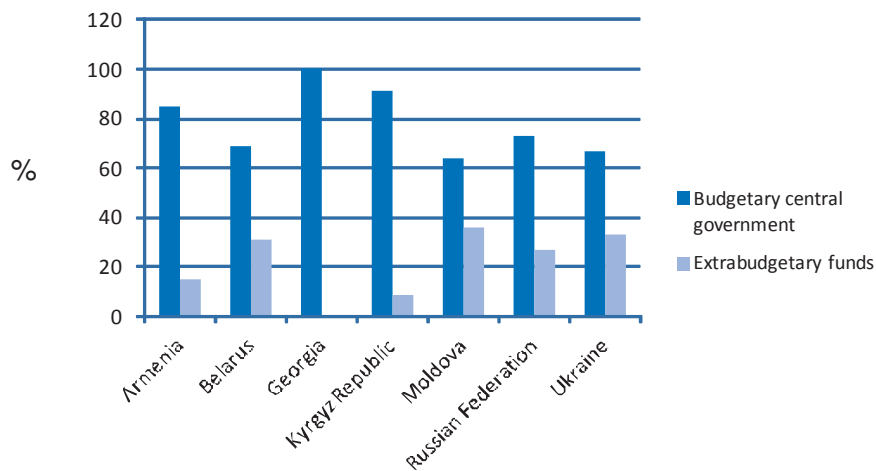
Despite political and economic challenges facing the EECCA countries over the years, consecutive EECCA governments have managed to implement a set of crucial reforms in their public administrations and institutions. Changes in the public finance sector have been closely linked to the overall governance reforms in these countries and they have brought significant improvements in the legal, regulatory and institutional framework for budget management. Most EECCA countries have introduced the basic public financial management reforms and have launched, to one extent or another, more advanced reforms in the sector. The 2008 financial and economic crisis however revealed remaining structural weaknesses in the budget systems of these countries and the need for their further strengthening, should the budgets deliver the social benefits expected from them.

Most of the reforms in the public finance system can be roughly divided into two stages: first, basic public financial management (PFM) reforms and then, more advanced PFM reforms. The basic reforms include, the introduction of a: (i) complete budget classification; (ii) complete budget coverage and capital budget integration; (iii) consolidated treasury single accounts; and (iv) adequate budget controls. The advanced PFM reforms include, most often; the following: (i) medium-term budgeting or medium-term expenditure frameworks (MTEF); and (ii) performance-oriented and programme-based budgeting. These budgeting approaches are actually closely interrelated.

### *Basic public financial management reforms*

Most of the surveyed countries have implemented a number of basic PFM reforms. The countries have introduced a full classification of government revenues and expenditures by economic, functional, organisational and funding codes.<sup>5</sup> In most cases, the budget classification is based on the IMF Government Finance Statistics (GFS) methodology which is good enough for statistical purposes but not as a basis for a proper programmatic MTEF. The introduction of programme-based MTEFs facilitates the attribution of public finance transactions to individual policy areas and creates conditions for the analysis of the social and economic effects of government revenue collection and spending policies.

Progress is also visible in consolidating various types of government resources (extra-budgetary funds, public investment programmes, quasi-fiscal activities)<sup>6</sup> into budget documentation going through legislative scrutiny and in creating treasury systems and single treasury accounts. In the environment sector, countries like Kazakhstan, Moldova, the Russian Federation, Ukraine either completely eliminated their extra-budgetary environmental funds or transformed them into budgetary funds. However, in some countries a number of extra-budgetary funds remain (these are usually social protection funds, disability funds, employment funds as well as oil reserve funds). In countries like Belarus, Moldova, Ukraine, substantial central government resources (sometimes more than 30%) are channelled through such extra-budgetary funds (see Figure 2.5).

**Figure 2.5. Share of extra-budgetary funds in central government expenditures**

Source: IMF Government Finance Statistics, 2007.

While budget coverage and capital budget integration generally improved, dual budgeting<sup>7</sup> is still an issue in many countries in the region. On the other hand, the barter and other non-monetary transactions (including environmental pollution charge offsets) and tax privileges for different sectors were largely eliminated. Also marked improvement was achieved in fighting value-added tax (VAT) frauds and reduction of VAT arrears. Most EECCA countries also established Supreme Chambers of Audit (or some equivalent) with the main purpose of strengthening the control of the expenditure of budgetary entities.

All these reforms have been consolidated through the adoption of modern and comprehensive Budget Codes in many of the countries which have also introduced new concepts and approaches to budgeting and public finance management.

### ***Advanced public management reforms: medium-term expenditure frameworks***

Most of the EECCA countries have introduced MTEFs in one form or another. The countries are at different stages of MTEF development and implementation. Armenia<sup>8</sup> was the first to introduce a MTEF as early as 1999 and Kazakhstan only did so in 2008. These are rolling three or four year, often forecasting, expenditure frameworks (except in the Russian Federation). In many countries, however, efforts to introduce a MTEF have ended up as a resource-consuming effort, often, of little practical value.

The Russian Federation has gone as far as introducing not just an expenditure framework but three year budgets (see Box 2.1). The main discussion during budget preparation is consequently about the distribution of the non-allocated financial envelope or newly generated resources, and not about the adequacy of the existing three year appropriations (apart from discussions about the annual budget updates).

In a comparative perspective, this arrangement seems very similar to a budget process with multi-year estimates and ceilings as in a number of OECD countries that have moved to fixed or periodical expenditure frameworks. The main difference is that the Russian arrangement is codified as a three-year budget, allowing ministries to conclude multi-annual procurement and investment contracts (using a specific instrument – the federal targeted programmes) and to develop medium-term sectoral spending and

performance plans. While some protection of multi-annual estimates is important for ministries so that they can plan, too much rigidity can also have disadvantages. A three-year budget runs the risk of locking in expenditures, which might be problematic in a situation where large reallocations are needed (for instance, to make room for new political priorities or new reforms). Before the financial crisis, during the long period of continuous real growth in the government budget and stable political priorities, this risk was not seen as an issue. After the crisis hit the Russian Federation, the government had to temporarily suspend the three-year budget appropriations. Recently, in December 2010, the Russian Duma approved its three-year budget for the period 2011-13.

The majority of the EECCA countries prepare comprehensive macro-fiscal frameworks. This is the strongest element of the existing MTEF systems. In countries which are IMF programme beneficiaries (*e.g.* Armenia, the Kyrgyz Republic, Moldova), macro-fiscal projections and the related budget estimates are more likely to be kept updated.

While medium-term fiscal forecasts are prepared in all of the countries surveyed there is not yet a general culture within sectoral ministries of developing policy initiatives, costing policy changes and developing integrated (*i.e.* recurrent and capital) spending strategies. Medium-term spending proposals are not always reconciled with the resources available during the budget period. As a result, the spending plans become mere wish lists and have a limited impact on annual budget preparation or on medium-term resource allocation.

Most countries have introduced multi-year aggregate expenditure ceilings with the purpose of increasing budget predictability for sectoral ministries, while containing aggregate expenditures at an acceptable level. Most often, expenditure ceilings are related to broad functional categories and are only indicative. In order to meet the objectives of enhancing predictability and fiscal control, the ceilings will need to be related to specific organisational entities and programmes (sector ceilings), which can be held accountable for not exceeding the limits, and to have a formal status in the budget process.

### Box 2.1. Russian budget system reforms

Reforms in budget procedures were introduced with the Budget Reform Concept paper for 2004-06. The declared objective of the reforms was to move from a system of budget management focusing on costs to a system of management by results.

There are five main elements of this reform:

#### 1. Reform of the budget classification and accounting

This involves a move away from excessive detail in budgeting nomenclature and toward the approval of main items contained in the Budget Code. This is consistent with a single chart of accounts for government institutions closer to internationally approved standards which allows a phased transition to accrual accounting. The main changes proposed to the budget classification affect the functional classification with the aim of reducing the 27 categories to 11.

#### 2. A clear differentiation between existing and new policy commitments when preparing the budget

Recognising that 90-95% of commitments are already “locked in” and the new programmes only take up 5-10 % of the budget, a differentiated treatment is proposed for approval of a baseline budget and approval of new policies which will further lock in the budget in the future.



### 3. Introduction of medium-term budget planning

A move away from the annual approach to budgeting to the approval of an indicative rolling budget framework for three years, broken down by government department and further on to fixed three-year budgets.

### 4. A streamlining of the budget process

Most notably, the number of readings for the budget is reduced from four to three. The first reading only discusses the broad parameters and the committed “old policy” budget; the second reading discusses new policy; and the third reading is a general review of the entire budget with detailed annexes for each main budget institution. The practice of approving the detailed budget classification under a separate federal law is replaced by a law fixing only the main codes of the classifications that are mandatory for all budget levels.

### 5. Introduction of programme and performance budgeting methods

Introduced as a two-year “experiment”, budget institutions were first invited to prepare and execute their budgets on a result-oriented basis for the 2005 and 2006 budgets. Specifically, there is a requirement for budget institutions to report on results and to develop mechanisms for monitoring the efficiency of resource use. This implies that federal “earmarked programmes” for large investment, research and structural projects will be restructured to reflect efficiency objectives (and their number will be reduced). Departments will also introduce targeted programmes, smaller in scale and focused on the extension of services or projects, along with agreed procedures that emphasise objectives, indicators for these objectives, and measures of results. Budget institutions are required to submit annual reports on the results of their main activities with an assessment of the efficiency of spending by indicators determined in advance and with agreed powers and responsibilities for different management units for each activity.

6. In 2010, the Russian government adopted a Programme for the improvement of the effectiveness of budget expenditure. The major elements of this Programme, include, among others:

- the formulation of a programme budget and a new budget classification;
- the increase of the effectiveness of government services by developing new forms of government enterprises, assigning new tasks to government enterprises;
- development of effective forms and methods of public financial control.

*Source:* Adopted from Diamond, J. (2006).

To enable a rational MTEF discussion, it is essential that sector spending programmes be prepared within sector expenditure ceilings as well as separate the costs of existing policies from new spending initiatives, which is rarely the case in EECCA. In most cases, the MTEF includes some basic descriptions of sector strategies. Most ministries and other spending agencies lack a well-defined sector analysis and explicit set of policy objectives.

The MTEF provides an important basis for the co-ordination of current and capital spending. This is the weak point of many budget systems and EECCA budgets often fail to recognise the costs required for the maintenance of existing capital assets and the operational costs of new capital projects. In addition, the quality of a sector spending programme will generally depend on whether the country has introduced performance-oriented budgeting. Most EECCA countries have done this as well but performance budgeting is more a formal exercise and has mostly a declarative character.

Many EECCA countries have set up MTEF Co-ordinating Committees chaired usually by the Minister of Finance. Committee members comprise officials from the different government ministries, representatives of local government bodies, the trade unions, the business community and civil society. In addition, there are sector Working Groups which are responsible for drafting sectoral MTEFs and preparing related justifications.

However, there is often a lack of ownership in the budget formulation process by policy makers. Policy and law makers get involved in budget formulation at quite a late stage – only after the sectoral ministries and other government agencies have submitted their budget requests, including requests for new initiatives, and the Ministry of Finance has put together a complete first draft of the budget. The budget preparation process is often fragmented. It is not rare that the preparation of the MTEF document and the annual budget proposals are managed as two parallel processes. As a result, the links between the annual budget and the MTEF estimates could be quite poor.

### Environmental governance structure and main environmental authorities

Not surprisingly, environmental authorities in the EECCA countries have been part and parcel of the reforms in the administrative and public finance systems in these countries. It can be expected that the procedure for medium-term financial planning and the use of budget funds at the ministries of environment will not be substantially different from the general procedures and rules that apply to all budgetary entities in each of the EECCA countries. Ministries of environment face similar challenges that other ministries encounter in competing for funds from the budget for implementing their programmes. However, in a certain way, the environmental sector is somewhat different from most other sectors particularly in that it is strongly cross-sectoral in nature.

This cross-sectoral nature of environmental and natural resource management raises a number of issues that are less prominent in other parts of the government administration. These issues include, among others:

- a. **Co-ordination** is critical for success. Often, most of the heavy public environmental investments are done in other ministries and agencies. For this reason, the way environment sector strategies are developed must take into account the need for a strong co-operative approach.
- b. **Targets and accountabilities** are harder to define as many actors contribute to a given output or environmental outcome. Indicators often lack hard, quantifiable targets for performance measurement.
- c. **Accurate costing** of environmental programmes can be hampered by the many actors involved as well as by the long-term nature of some environmental programmes and the lack of reliable data. For this reason, the results from environmental, particularly investment, programmes and projects will rarely, if ever, be seen within the framework of the annual budget.
- d. **Environment is often not a policy priority.** Social sector spending is the focus of national policies. In addition, at times of budget deficit or financial crisis, the environment sector is often among the first ones to suffer budget cuts.

Because of these specifics of the environmental sector, environmental authorities in the EECCA countries often run the risk of being marginalised, particularly at times of crises. One particular issue though that requires attention is the fragmentation of the environmental sector. While in general, it is ministries of environment (or some equivalent) that have the main responsibility for environmental management and regulation, it is sectoral ministries of water, energy, agriculture, forestry that are often charged with actual policy implementation.

Only in the Kyrgyz Republic and Uzbekistan there are no ministries of environment, instead environmental management in the Kyrgyz Republic is assigned to an agency which is under the direct responsibility of the President and in Uzbekistan – it is the State Committee for Environmental Protection which is the main environmental authority in the country.

In addition, of the ten countries that participate in the survey, Azerbaijan, Belarus, Georgia, the Russian Federation and Ukraine have an environmental authority which combines responsibilities for managing both natural resources and environmental protection. With such an institutional arrangement the management of natural resources often overshadows environmental pollution management functions. And even in this case, certain functions are jointly carried out with other relevant ministries, agencies or committees. In the other five countries, responsibilities for environmental management are largely allocated across a great number of institutions, the usual suspects being, ministries (or some equivalent) of agriculture, water, energy, forestry, industry and economy, geology, trade, tourism. This highly complex nature of the environmental sector (and not only in the EECCA region, of course) significantly complicates the communication across institutions and the implementation of national environmental policies. In addition, the vertical distribution of environmental management responsibilities across different levels of government creates further difficulties. It is small wonder then that the allocation of budgetary resources for the environmental sector is such a hard issue. Collecting data on environmental expenditure, on how much is spent and for what purposes, not only in the private sector but in the public sector as well, is a real challenge.

More importantly, the frequent reorganisation in the ministries of environment have often resulted in long transition periods of institutional uncertainty and inaction, as well as the loss of qualified staff and institutional memory. In some cases (such as in the Kyrgyz Republic), the restructuring process limited the influence of environmental authorities over government policies. Cases of incoherent institutional changes under the same government (such as in Moldova and the Russian Federation) suggest a lack of strategic direction for institutional reform.

Internationally-recognised issues, such as climate change and more recently, the green growth initiative, have contributed to raising the profile of environmental authorities, including in the EECCA countries. This is a particular window of opportunity as it creates consensus within the entire government on finding political solutions. Such initiatives are not any more the cause of environmentalists only, they become streamlined into national priority policies. Ministries of Finance and Ministries of Economy are at the forefront of such processes and start providing the much needed leadership which has often been missing in the environmental sector.

EECCA environmental administrations need to take advantage of the opportunities that international processes provide. To be able to support national initiatives, EECCA ministries of environment need to have a stronger presence in the debate on policies in their countries. Preparing and proposing economically well justified programmes, which merit

the attention of the rest of the government, is the best way of promoting environmental objectives.

### **Demand for robust multi-year environmental programmes**

Demand for good practices for preparing robust multi-year environmental programmes in the EECCA countries is rather low. Demand is different from the willingness to increase and improve ministries of environment staff knowledge in financial planning and expenditure management. However, demand, unlike willingness, can be created. It is created through relevant legislation, regulations, rules and procedures. Formally, there is legislation in the EECCA countries aimed at improved expenditure planning, allocation and management of public resources but it often has a declarative character only and is not consistently enforced in practice. Ministries of Finance and the Cabinet of Ministers have a very important role to play in creating such demand.

Demand is shaped by both domestic and international requirements. Climate change and green growth, internationally, or the reforms in the domestic public administration and public finance systems provide powerful incentives to environmental administrations in the EECCA countries to improve their expenditure management practices if they want to compete successfully for budget resources. Changes in donor practices and the gradual shift from project financing to direct budget support is yet another driver that should encourage EECCA environmental administrations to improve their traditional ways of operation.

Most of the EECCA countries have developed and put in place policies and legislation that deal with public environmental expenditure planning and management, that programming is part of. However, much of this legislation is rather weak, not prepared in line with good international practices and poorly enforced.

Creating demand for better practices for the planning and the management of environmental expenditure should not be a concern of ministries of environment only. It should impact other government agencies and levels with responsibilities for environmental management, including potential beneficiaries of public support.

Programming (which involves, among other, setting objectives, targets, establishing the optimal level of subsidy support) and project cycle management (setting rules and procedures for identifying, selecting and financing the most cost-effective projects to be supported through a given programme) are particularly weak in the EECCA countries. The lack of good programmes is not specific to the environmental sector only. This shows that demand from higher levels of government may not be sufficient. Unfortunately, the reality is that even if other ministries are not particularly better than ministries of environment in preparing programmes, because of political priorities, these other ministries are in a position to obtain more adequate resources anyway. Therefore, the best way for EECCA environmental authorities to break this vicious circle is by developing their capacity to design, cost and defend their programmes on both environmental and economic terms and in line with good international practices.

It is clear that such a change cannot happen overnight. Problems with remuneration in the sector and staff capacity have been known for years. However, if EECCA ministries of environment want to move forward, they need to act. Among others, they could conduct detailed reviews of their expenditure management systems (programming and project cycle management) in order to identify what works and what needs to be changed. While ministries do this sort of exercises routinely on many different aspects of their management, public environmental expenditure reviews, including the evaluation of rules and

procedures, are very rarely conducted. It seems that there is some reticence to addressing these issues. It goes without saying that such reviews need to be followed up by plans of actions for reforms. Incrementally small but consistent changes may sometimes be better than “big-bang” reforms.

Such reviews, if conducted closely with the ministries of finance/economy and other relevant stakeholders, can provide the basis for a broad debate in the government on specifically needed reforms in the sector. The sector, in this case, implies also other relevant government agencies which manage environmental programmes and provide public resources for environmental activities. Harmonising rules and procedures across the government may be particularly beneficial. Opening such a policy dialogue can help ministries of environment to become more transparent, visible and more understandable to the rest of the government and society as a whole.

Introducing regulations and procedures on public environmental expenditure planning and management in line with good international practices and actually enforcing them can help increase the demand for good practices in this area. Training staff to be able to apply them over the longer term will inject stability and confidence in the system of public support for environmental expenditure. Obviously, donors can play a crucial role in supporting such efforts as can citizens’ and grass-root organisations.

## Major findings

The major findings that emerge from the above analysis are:

- The EECCA countries were hit hard by the financial and economic crisis that reached the region in late 2008. This resulted in significant economic decline. By the end of 2009, growth had resumed albeit at a slower pace compared to the pre-crisis period. However, the low tax revenue and significant government deficits coupled with a generally weak banking sector (with high interest rates and spreads) and decreasing FDI can limit the public expenditure capacity at all levels of governments.
- Despite general improvements in the environmental quality in the region, serious environmental problems, with important health and economic implications for the economies of the EECCA countries, still persist. Because of past pollution problems and the public character of environmental investments (that is, due to the low rate of return of many environmental investments which makes them less attractive to the private sector) such investments need public financing.
- Most EECCA countries have introduced a set of crucial reforms in their public financial sectors. Basic public financial management reforms include, among others, the introduction of a full classification of government revenue and expenditure by economic, functional, organisational and funding codes; consolidation of various types of government resources, including the elimination of extra-budgetary funds or transforming them into budgetary funds; the introduction of treasury systems and single treasury accounts; the establishment of Supreme Chambers of Audit to strengthen expenditure control of budgetary entities; the introduction of modern and comprehensive Budget Codes. Budget coverage and capital budget integration have generally improved but dual budgeting is still an issue in many of the countries.

- Most EECCA countries have also launched advanced public financial management reforms, such as MTEFs and performance-based budgeting. The first country to do so is Armenia (1999) and the last countries are Kazakhstan and Belarus, Ukraine and Uzbekistan have not yet introduced MTEFs as part of the budgeting process. The MTEFs are running, most often, three-four year, forecasting expenditure frameworks with the macro-fiscal framework being their strongest element. Where programmatic MTEFs have been introduced, the costs of existing and new policy initiatives are often not explicitly distinguished and performance indicators mostly have a declarative character. Multi-year programmes for inclusion in the MTEF/annual budget process are rarely designed and costed in line with international good practices and the MTEF and the annual budget process are often managed separately, as two parallel processes. As a result, the preparation of the MTEFs in these countries has often been a resource-consuming effort of little practical value.
- The fragmentation of the environmental sector and the frequent reorganisations in the EECCA ministries of environment have contributed significantly to the challenges with adequately financing priority environmental programmes in these countries. Internationally-recognised issues, such as climate change and the green growth initiative and the direct involvement of ministries of finance and economy at the forefront of these processes, have helped raise the profile of environmental authorities. But unless EECCA ministries of environment improve their expenditure planning and management practices, they will run the risk of being further marginalised in the competition for budget resources. Demand for improved expenditure management practices can effectively be created and is a responsibility of both decision makers but also citizens' and grass-root organisations. Donors also have a crucial role to play in supporting such initiatives.

## Notes

1. EBRD Transition Report 2010.
2. Bank non-performing loans to total gross loans are the value of nonperforming loans divided by the total value of the loan portfolio (including nonperforming loans before the deduction of specific loan-loss provisions). The loan amount recorded as non-performing should be the gross value of the loan as recorded on the balance sheet, not just the amount that is overdue.
3. Markandya (2009).
4. FAO statistics (2006).
5. See Annex I for a definition of different budget classification systems.
6. Quasi-fiscal activities refer to implicit subsidies to the utilities sector which are not accounted for in the budget as government expenditures.
7. Dual budgeting refers only to a dual process of budget preparation, whereby the responsibility for preparing the investment or development budget is assigned to an entity different from the entity that prepares the current budget.
8. In Armenia, until 2002, the MTEF preparation was not delegated to sectoral ministries and was prepared only by the Ministry of Finance and/or donors.

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## *Chapter 3*

### **Public environmental expenditure trends**

*This section looks at the environmental expenditure trends in the ten countries over a period of four years, 2006-09, based on data provided by the countries themselves. Data collection revealed some methodological and definitional challenges that sometimes made it difficult to interpret the data. Still, the analysis provides a basis for some cautious conclusions.*

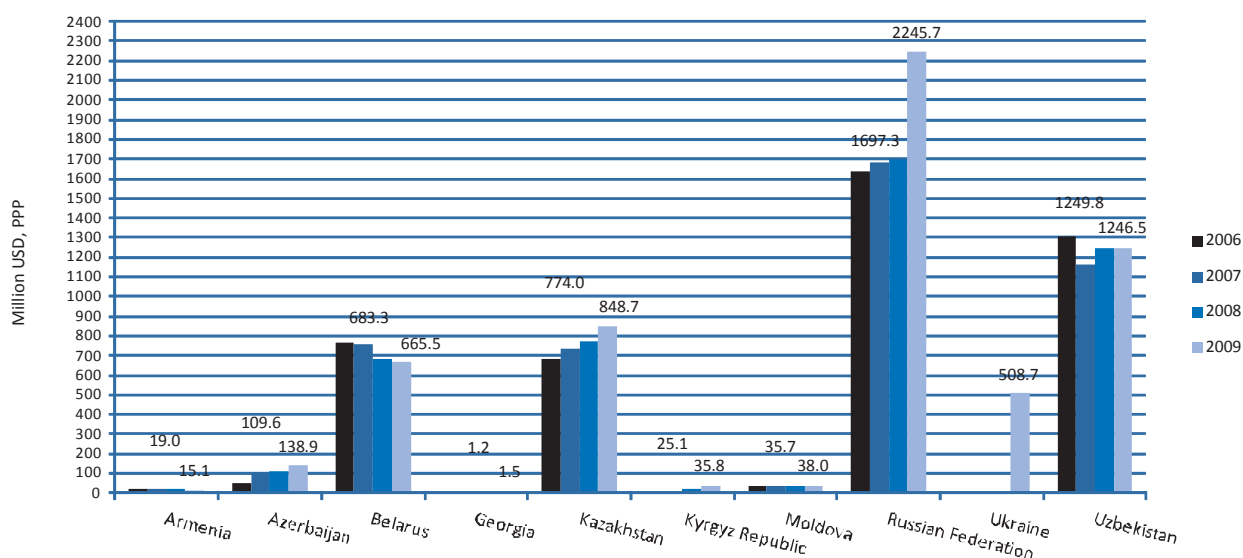
## Trends in the size of public environmental expenditure<sup>1</sup>

The commitment to address environmental issues can be best illustrated by analysing environmentally-related public expenditure in the surveyed countries and measuring their share in the total income of the economy. In addition, the purpose of the chapter is to show the size and nature of environmental expenditure that should be incorporated into the countries' medium-term expenditure frameworks (MTEFs), where these exist.

In **absolute terms**, total domestic public environmental expenditure<sup>2</sup> show a clear increasing trend over the time period 2006-09 (see Figure 3.1). Despite the financial crisis that hit the region in 2008, in 2009, domestic public environmental expenditure increased in comparison to 2008 in six of the countries (Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova and the Russian Federation). Only Armenia and Belarus reported a decrease in the expenditure, in Uzbekistan, the level of expenditure was maintained at the 2008 level, and Ukraine provided data only for 2009. Data labels in Figure 3.1 are provided for the years 2008 and 2009; the 2009 labels are shown at a lower level than 2008.

In 2009, total domestic public environmental expenditure, range from about USD 1.5 million in Georgia to more than two billion USD in the Russian Federation (all expressed in USD, purchasing power parities (PPP)). This significant difference in the expenditure levels most likely reflects the difference in the size of markets for environmental protection technologies as well as research and development in countries like Armenia or Uzbekistan. In the case of Belarus and Uzbekistan, high public environmental expenditure may be linked to the high share of state-owned enterprises in these countries (the private sector share in GDP was about 30% in 2008-09 in Belarus and 45% in Uzbekistan). Although the trend is generally increasing, these absolute amounts should be also seen against the very low public environmental expenditure levels in general and also in relative terms.

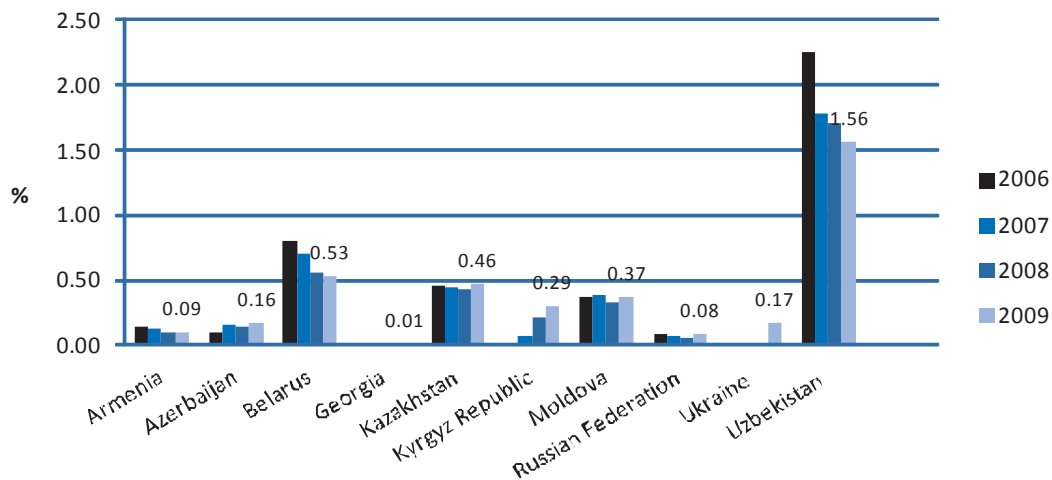
**Figure 3.1. Total public financing for environmental expenditure, USD million, PPP, 2006-09**



Source: Country data.

As a **share of GDP** (see Figure 3.2), public environmental expenditure in most of the countries generally decreased in the period 2006-09. The share of the reported public environmentally-related expenditure in GDP varies across the countries, from 0.01% of GDP in Georgia in 2009 to 1.56% of GDP in Uzbekistan in 2009, which has the highest public environmental expenditure among the surveyed countries throughout this period. These low levels of environmental expenditure may be partially explained by the fact that the numbers reflect the public resources only that go the environmental sector. Private sector contributions are not included here. It is unlikely though that the private sector will allocate significant resources for environmental financing in most of these countries.

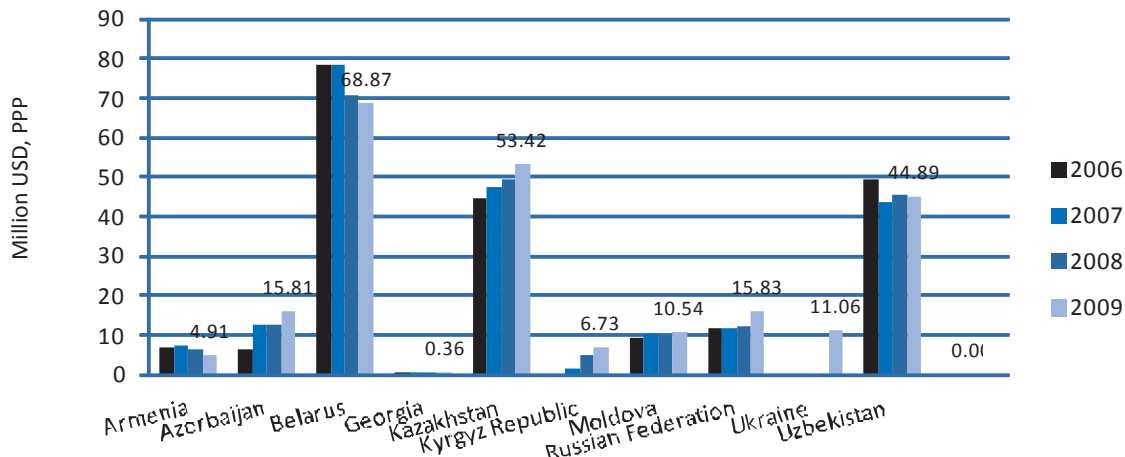
**Figure 3.2. Domestic public environmental expenditure as a share (%) of GDP, 2006-09**



Source: EAP Task Force Secretariat own calculations.

On a **per capita basis**, public environmental expenditure in the countries are also low and in 2009 ranged from less than one USD per capita in Georgia to about 70 USD per capita in Belarus, where they are the highest (Figure 3.3). In 2009, the per capita public environmental expenditure in half of the countries actually increased in comparison with 2008.

**Figure 3.3. Per capita public environmental expenditure, USD, 2006-09**



Source: EAP Task Force Secretariat own calculations.

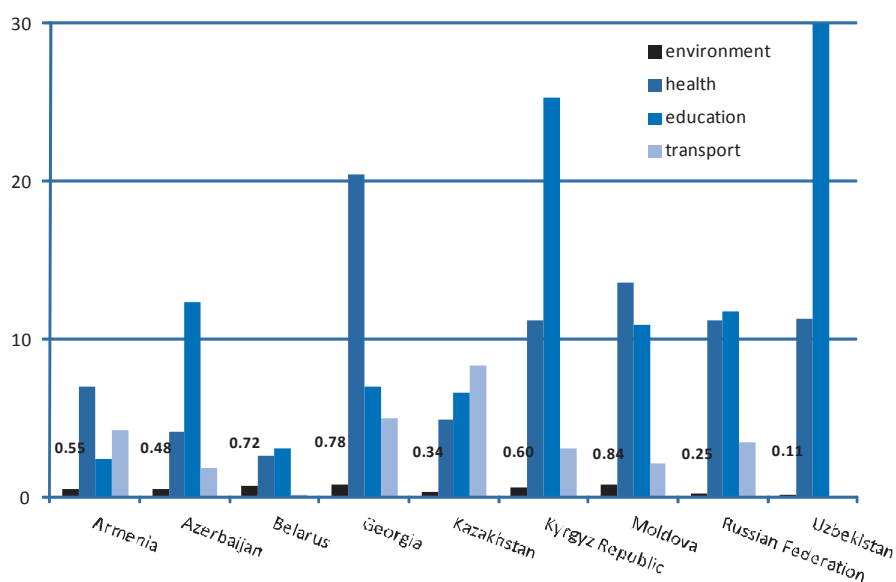
## Degree of consolidation of public sources of environmental financing

The MTEF was created with the aim of, among others, helping consolidate all sources that contribute to the public purse and provide a clearer and fuller picture of what will be available to the public sector in terms of potential revenue over the medium-term. Thus, the major question will be to see to what extent the MTEFs in the EECCA countries have helped make this picture more transparent, particularly in the environmental sector. Given, that some countries have introduced MTEFs only recently, it is difficult to make straightforward and general conclusions across the board. And yet, a certain picture is emerging.

The main sources of financing of public environmental spending within the medium-term expenditure framework include the general taxation system, environmental funds and donors funds, including direct budget support and sector support.

When it comes to support from the general budget, due to limitations of the project, we look only at the budgets of the national environmental administrations. Looking at Figure 3.4, it becomes obvious that the budgets of the ministries of environment in the EECCA countries are not just small compared to other social sectors, such as education and health, but they are simply negligible. As a share of total government budgets, in 2009, environmental authorities' budgets range between 0.78% (the highest) in Georgia to 0.11% (the lowest) in Uzbekistan.

**Figure 3.4. Government allocations to the Ministry of Environment budget as compared to other sectors, % of government budget, average for the period 2005-09**

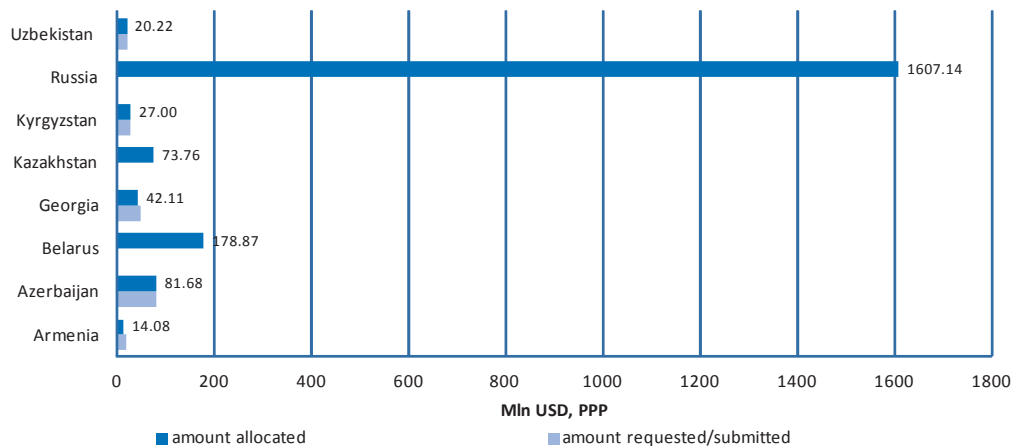


Source: Country data.

With regard to how resources requested by the ministries of environment compare to those that they actually received in 2009, Figure 3.5 shows that two countries (Azerbaijan and the Kyrgyz Republic) received more or less as much as they requested, while Armenia, Georgia and Uzbekistan received less than the requested amounts but the difference is not significant. Belarus and the Russian Federation do not specify the amounts requested, while Moldova and Ukraine did not provide such information. This picture shows two things.

First, the financial gap between resources requested and resources received from the budgets is generally small. It may also mean that there are sectoral expenditure ceilings in these countries that work well (of these countries only Belarus and Uzbekistan do not have a MTEF) and the ministries of environment do fit their requests within these ceilings. While the resources at an aggregate level may not be sufficient, at least, it seems that the ceilings provided at the beginning of the budget preparation cycle ensure some stability and certainty in the planning process.

**Figure 3.5. Ministry of Environment budget, amounts requested versus allocated, USD million, 2009**

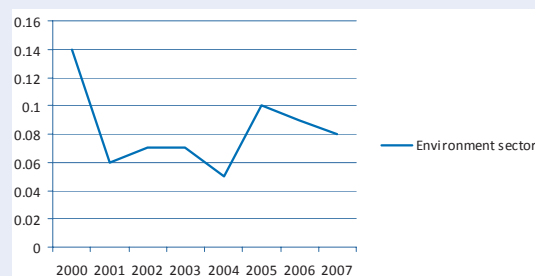


Source: Country data.

### Box 3.1. The Russian Federation – Budget Strategy for the period until 2023

In the Russian Federation, the Budget Strategy until 2023, shows that between 2000-07, the environmental expenditure in the consolidated budget, as a share of GDP (excluding the transfers from extra-budgetary funds), were going down and they were the lowest compared to all other sectors. For the same period, environmental expenditure financed from the federal budget (including transfers from extra-budgetary funds, as a share of GDP) must have been extremely low as they are reported to have been 0% of GDP. This comes to show that the Russian Federation's spending on environment at the federal level is negligible. This is also reflected in the data which show that the Law on the Federal Budget on the Federal Targeted Programmes does not explicitly mention any environmental programmes. The legitimate question is why the federal Ministry of Natural Resources does not seem to support any long-term programmes. Some environmental expenditure are probably covered through other programmes (*e.g.*, the destruction of the storage of chemical arms) but this is mainly a guess work. At the same time, other federal programmes, such as “The Protection of the Lake Baikal”, “The Reduction of Technogenic Risks” can also cover some environmental expenditure.

#### The Russian Federation, Environmental expenditure in the consolidated budget as a share of GDP, 2000-07



On the other hand, expenditure in the public utilities sector would include environmental investments as in the water utilities, or the heating sector, and these expenditure have been increasing between 2000-07, but it is not clear what the share of environmental services in these expenditure is. And if the past trend of the Russian environmental expenditure looks rather gloomy, the 2023 budget strategy does not envisage anything better for the Russian environment: environmental expenditure until 2023 are envisaged to remain stable, at the low level of 0% of GDP (in the federal budget) and 0.1% of GDP (in the consolidated budget).

How do these budgetary allocations look like in the context of the MTEF process? Table 3.1 provides some answers for the eight countries that provided information, namely all countries that have MTEFs in place, except Belarus and Ukraine. Within the medium-term expenditure framework, budget estimates are revisited on an annual basis. Two countries, the Kyrgyz Republic and Moldova have always enjoyed higher actual allocations than requested, Georgia – has always received less than requested, Armenia always received more than requested in the pre-crisis years, but in 2009, it received less, while in Azerbaijan and the Russian Federation – it is exactly the opposite: In the pre-crisis years, these two countries always received less than requested while in 2009, the actual allocations were higher than requested from the budget. Receiving more than requested is somewhat understandable in the good times like the period before the crisis when most countries enjoyed a stable growth. With the existence of budget surpluses, the additional financial envelope was allocated across the sectors and the ministries of environment seemed to have benefited as well. It is more difficult to explain the higher allocations in 2009, but these should be seen against the very low budget allocations made for the environmental sector in these countries.

**Table 3.1. Comparing out-year MTEF estimates with budget allocations to ministries of environment, USD million**

Country		2005	2006	2007	2008	2009
Armenia	MTEF (n + 1)	17.36	17.54	21.27	20.43	15.24
	Budget allocation (n)	15.27	19.68	20.65	23.55	14.08
Azerbaijan	MTEF (n + 1)	65.95	75.97	71.32	77.17	101.98
	Budget allocation (n)	43.25	51.38	58.82	58.66	79.95
Georgia	MTEF (n + 1)	44.02	41.04	50.04	36.29	44.17
	Budget allocation (n)	17.30	23.50	35.02	32.30	41.99
Kazakhstan	MTEF (n + 1)	96.58	88.43	91.66	102.88	73.76
	Budget allocation (n)	N/A	N/A	N/A	N/A	N/A
Kyrgyz Republic	MTEF (n + 1)	4.60	6.14	8.74	8.18	27.01
	Budget allocation (n)	4.97	7.88	8.69	10.39	27.00
Moldova	MTEF (n + 1)	10.78	14.05	16.61	18.02	18.97
	Budget allocation (n)	11.50	14.05	22.24	18.68	18.47
Russian Federation	MTEF (n + 1)	1769.79	1709.01	1766.65	1847.83	2245.67
	Budget allocation (n)	1708.54	1636.02	1679.77	1697.28	2207.79

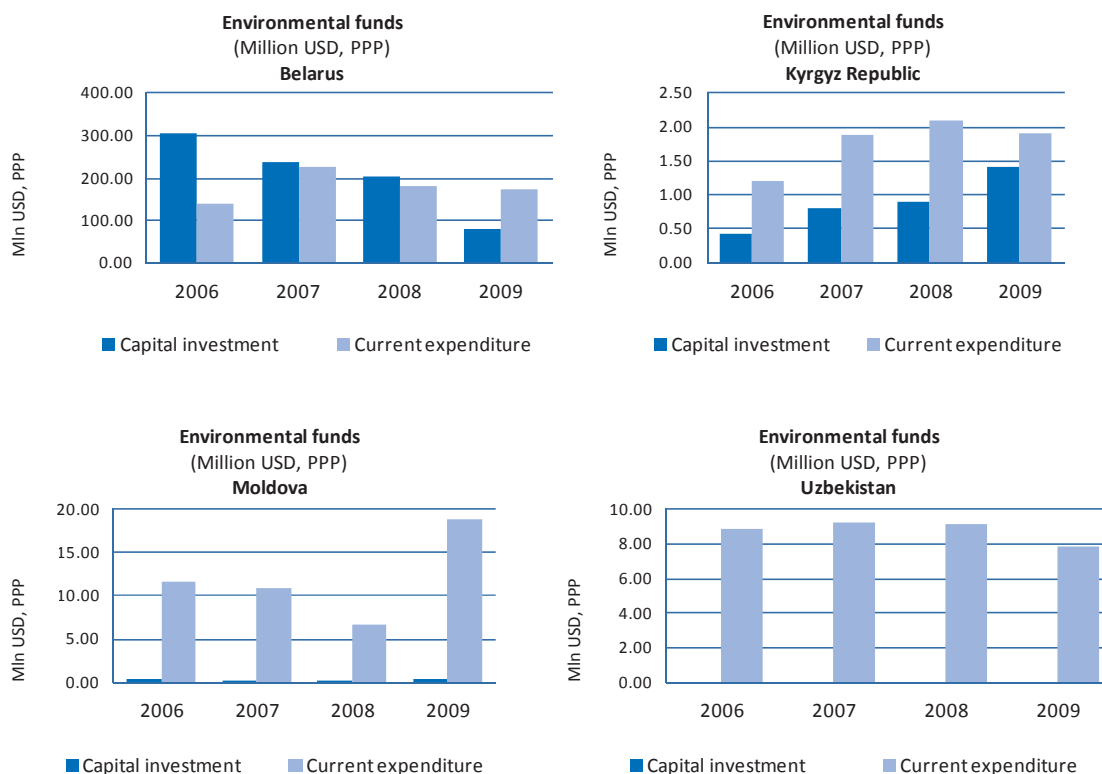
Source: Country data.

Despite these low levels of resources, with regard to the execution of the ministries of environment budgets, most of the countries reported that over the period 2005-09 they spent less than they received, except in Uzbekistan, where they managed to spend all the money allocated to the ministry. It seems that even if the amounts are small, the ministries may have had some problems spending their money in total. It is interesting to note that quite often the execution of the ministries of environment budget is not any worse, and in many cases even better, than the performance of the national government budget as a whole (for more information on this issue, see the Country fact sheets, at the end of the report).

In the context of public environmental expenditure, one of the major sources of financing in the EECCA countries, are environmental funds. The revenue of environmental funds is usually generated from environmental pollution charges and fines which are earmarked for environmental activities. In most countries, these funds were initially created as extra-budgetary entities, but as discussed earlier, in many countries in the early 2000s, the funds were consolidated into the budgets.

Four countries reported that they use earmarked environmental funds to support environmental activities: Belarus, the Kyrgyz Republic, Moldova and Uzbekistan (see Figure 3.6). We need to make two points here. First, in 2006-09, of the four countries, only Belarus provided more support for investments through their environmental funds than for current expenditure. In Moldova, most of the resources of the funds were spent on current expenditure and in the Kyrgyz Republic, more than half of the Funds' resources were used to support current expenditure. In Uzbekistan, all Funds' resources are spent exclusively on current expenditure. In principle, earmarking of public resources is discouraged on efficiency grounds as there are vested interests and resources are locked in and spent even when public support may not be needed any more. Earmarking may be temporarily accepted as a way to support significant investments which will not happen without public support, which is the case of the environmental sector. However, it is not acceptable to support current expenditure through earmarked public funds as this creates wrong expectations on the part of beneficiaries that the public purse will provide the money forever.

**Figure 3.6. Capital investment *versus* current public environmental expenditure provided by environmental funds, 2006-09**



Source: Country data.

Experience from many countries shows that the existence of earmarked funds often leads to a decrease of regular budget resources for the ministries of environment. The more the environmental funds revenues grow, the more the regular budget may decrease. As long as this situation persists, ministries of environment can hardly expect that the Ministry of Finance and the government, as a whole, will pay sufficient attention to the environment and allocate adequate resources from the general budget. More importantly, the fact that the ministry of environment is entitled to this revenue by law, without really competing for it, reduces the incentives for the ministry's staff to prepare solid and convincing programmes and allocate the resources in a cost-effective and efficient manner.

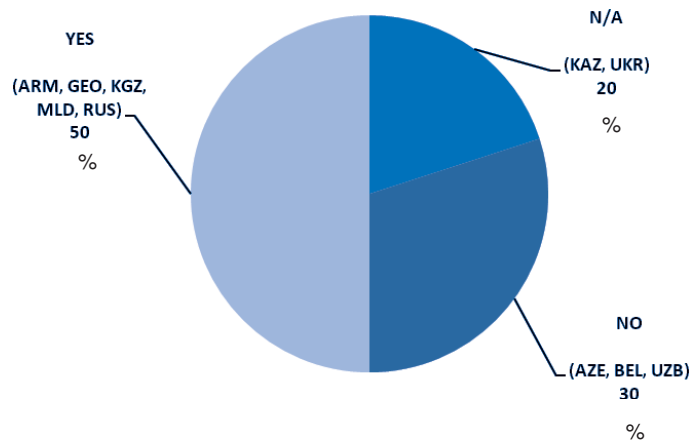
As for the support for the environmental authorities coming from donors, only three countries provided data: Armenia, Azerbaijan and Moldova. While donor support, as a share of the ministries of environment budget, in Azerbaijan is rather negligible (less than 2%, on average) over the period 2005-08, in Moldova it is about 15%, in Armenia donor support is significant (about 50% on average over the same period). Of this contribution, Armenia reports that about 20% is allocated for carbon financing, while in Azerbaijan – this share is higher – about 30%. In addition, in Armenia, the volume of carbon financing has significantly increased between 2006 and 2008 – more than twice.

It is also interesting to see how much of donor support is on or off-budget and to what extent donors are moving towards direct budget support in these countries. With regard to the budget status of donor funds for the environment (see Figure 3.7), Azerbaijan, Belarus and Uzbekistan report that these funds are still off-budget, Kazakhstan and Ukraine did not



provide such information, in the rest of the countries, budget support is already on-budget. Armenia specifies that most of the funds are on-budget but a certain share is still off the budget, and this share has been decreasing over the years (from about 40% in 2006 to about 20% in 2008).

**Figure 3.7. Are donor funds for the environment on-budget?**



Source: Country data.

Although there is no sufficient information, data on donor contributions show that direct donor support does increase, and it increases significantly. We know, for example, that donor support in Ukraine is also increasing although project financing for the environment is still predominant. Carbon financing is also increasing as a source of revenue for the environment. It is disappointing though that so very few countries chose to provide information on this issue. Chapter 5 contains more detailed discussion on this issue.

Due to the fragmentation of the responsibilities for environmental management across many different ministries and government agencies, it is difficult to get a clear picture of what these other institutions are spending on environmental programmes. Unfortunately, it was not possible within the framework of this survey to carry out such analysis. As a result, it is hard to say to what extent the sources of revenue of these other agencies are integrated and consolidated into the medium-term expenditure frameworks in the countries.

Altogether, it seems that, to date, the MTEFs may have, including in the environmental sector, somewhat helped consolidate public resources. But it is difficult to see direct and straightforward links. Maybe this is mostly visible when looking at environmental funds and donor support. It is true however that the consolidation of extra-budgetary funds started even before the introduction of MTEFs, hence it is hard to attribute this process to the MTEFs only. The consolidation of donor funds and bringing them on the budget, on the other hand, seem to owe more to the introduction of MTEFs. This is a slow process but the situation is improving. In addition, the existence of top-down sectoral ceilings also seems to have injected some stability and predictability in the flow of resources coming from the general budget.

### Public environmental expenditure structure and its deficiencies

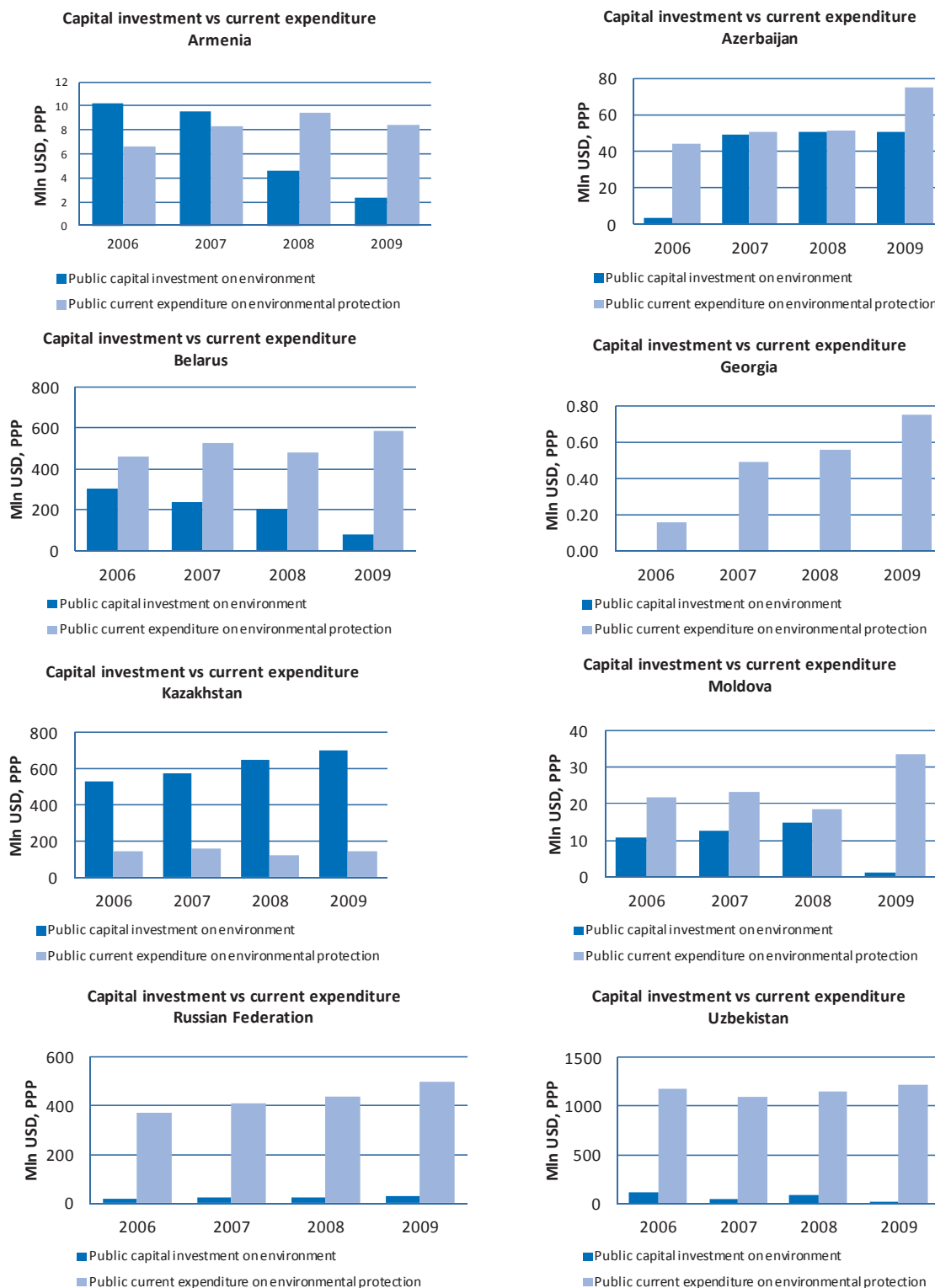
The structure of environmental expenditure is discussed mostly in terms of investment versus current expenditure and expenditure distribution by environmental domain. All countries provided relevant data, except Ukraine.

Generally, current expenditure are the more important component of public environmentally-related expenditure (see Figure 3.8). Apart from Kazakhstan, where the government spent much more on supporting investments than current expenditure in the reviewed period, almost all other countries (except Armenia in certain years) spent more on current than on investment expenditure. Georgia spent all on current expenditure only. Their resources mostly on current expenditure. Investment levels in most countries decreased in 2009 in comparison with previous, pre-crisis years except in Kazakhstan where they slightly increasing on a year-per-year basis and in Azerbaijan where they remained more or less stable. Uzbekistan has chosen to present additional data on public environmental expenditure which are included the Country fact sheet. The picture that emerges from the data provided by the countries on current versus investment spending on natural resource management shows that the countries do not make basically any investments in this sector.

In terms of public spending on the environment by media or domain (see Figure 3.9), in 2009, in Armenia and Kazakhstan, most public resources went to nature protection and conservation – about 50% in Armenia and more than 70% in Kazakhstan, while in Azerbaijan (more than 20%), Belarus (more than 70%), Moldova and the Russian Federation (about 40%) these resources were spent on water resources protection. In 2009, the Kyrgyz Republic, Ukraine and Uzbekistan spent most of their resources on waste management, more than 20% in the Kyrgyz Republic (a similar share was also spent on environmental monitoring), about 40% in Ukraine and more than 60% in Uzbekistan. Georgia spent most of the resources on environmental monitoring, that is, about 40%. As can be seen on Figure 3.9, some countries, *e.g.* Azerbaijan, Georgia, the Russian Federation, spent significant amounts on “Other” domains which were not always specified. In Azerbaijan, for example, in 2008, the resources included in this category were split among the following areas: infrastructure development, protection of mineral resources, forest protection and development, protection of biodiversity in water resources, administrative expenses. One question to ask is why infrastructure development cannot be split by environmental domains, or why the protection of mineral resources is not included in the “mineral resources conservation” category which was explicitly included in the survey. Altogether, there seems to be some overlapping among expenditure classifications and double-counting of expenditure levels.

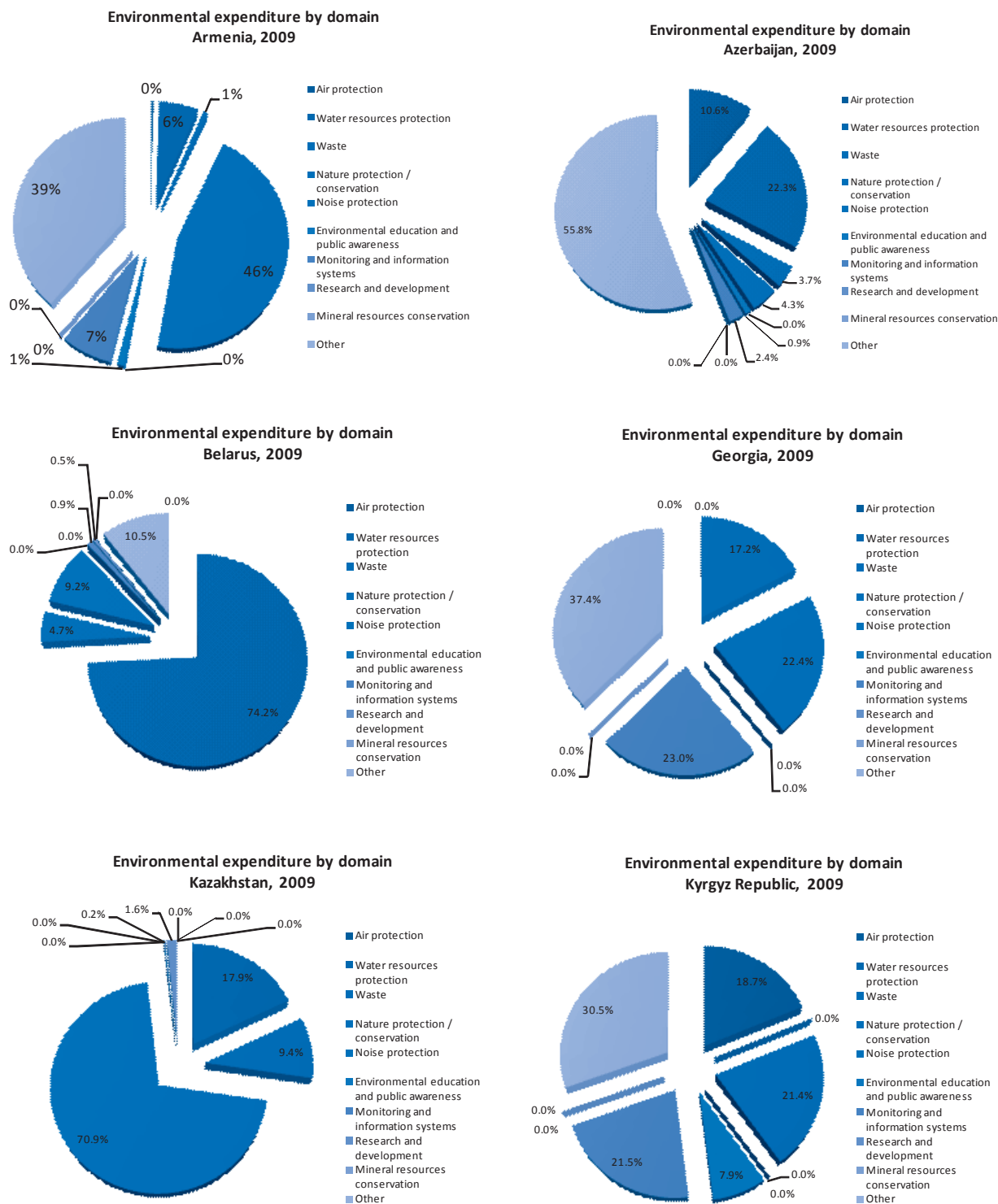
One particular problem that emerged during the analysis is the poor quality of data provided by some of the countries. The survey was conducted in several stages and during each round of data gathering and verification, numbers and magnitudes would change, in some cases significantly, information would change. This posed a lot of challenges during the analysis but it also raises concerns about the reliability of data. For this reason, numbers here should be treated with caution. This lack of reliable data becomes even more important when cost and expenditure estimates need to be prepared on a medium-term basis in the context of MTEFs. If good quality data are missing it is difficult to prepare realistic and credible analysis. Even more importantly, it is difficult to analyse the effectiveness and efficiency of the public resources spent on solving one or another environmental problem. Such a situation cannot meaningfully support debates of policy makers that need to make informed decisions.

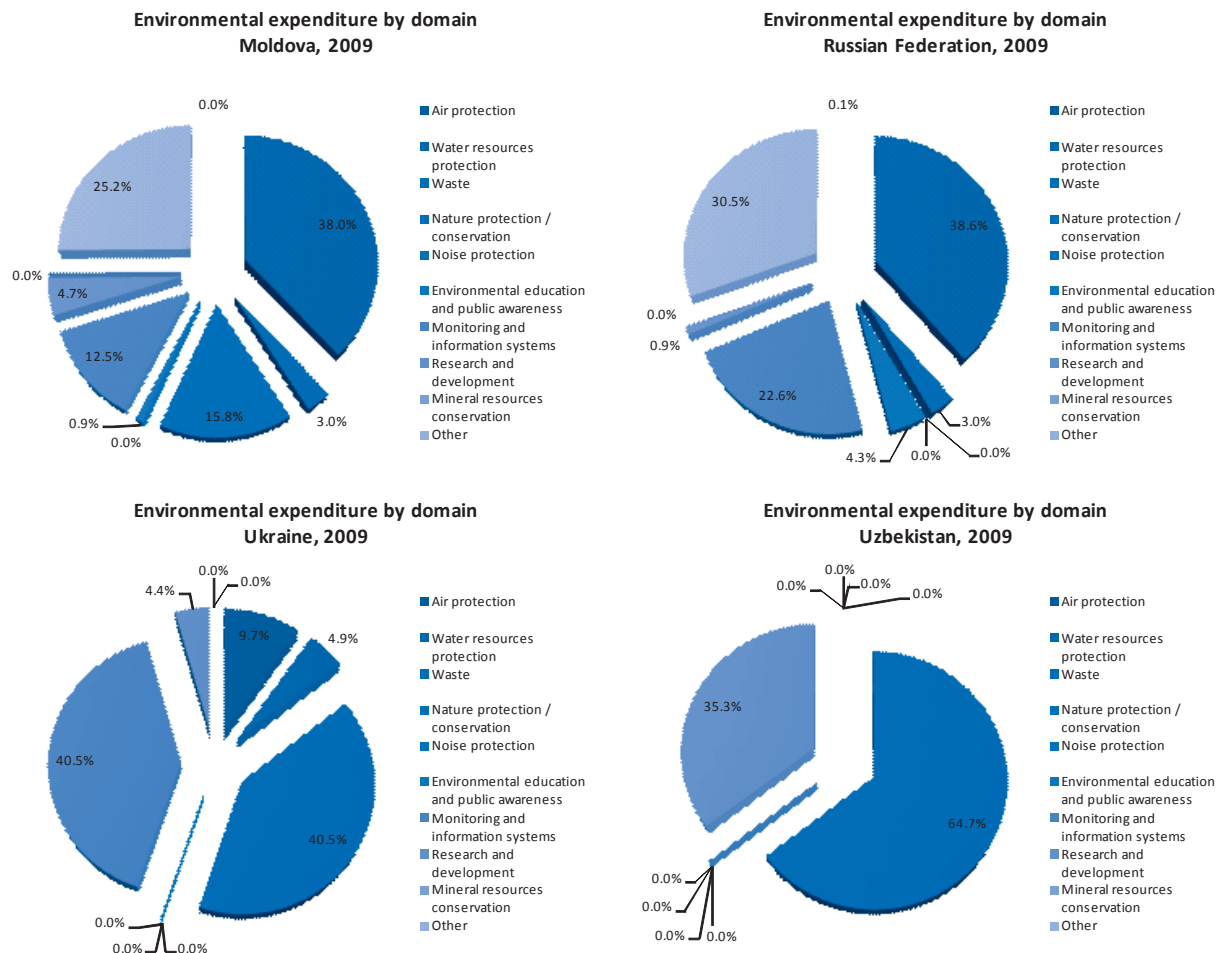
**Figure 3.8. Capital investment versus current public environmental expenditure on environmental protection, USD million, PPP, 2006–09**



Source: Country data.

Figure 3.9. Public environmental expenditure by domain, shares of total expenditure, 2009





Source: Country data.

## Main findings

The main findings that emerge from the above analysis are the following:

- While public environmental expenditure in the surveyed countries were generally increasing in absolute terms, as a share of GDP and on a per capita basis they are very low. When compared to the budgets of other social sectors (education, health), public environmental expenditure budgets are almost negligible. Most public expenditure in 2009 go to water and nature protection conservation.
- Earmarked environmental funds, where they exist, still support to a high degree, current expenditure rather than investments. As long as this situation persists, ministries of environment risk getting less resources through the regular budget process.
- Carbon financing in the countries that provided data is generally increasing but very slowly. Direct budget support is gaining grounds but all forms of donor support are still co-existing. Some of this donor support is still off-budget rather

than on-budget which creates challenges to consolidating the public resources with the medium-term expenditure framework.

- All countries experience problems with collecting public environmental expenditure data. Poor data undermines the quality and the credibility of programmes offered for inclusion in the MTEF/annual budget process and prevents decision makers from making informed judgements.
- There is some evidence that the MTEFs may have contributed to the consolidation of public resources. This is mostly visible when looking at environmental funds and donor support. It is true however that the consolidation of extra- budgetary funds started even before the introduction of MTEFs, hence it is hard to attribute this process to the MTEFs only. The consolidation of donor funds and bringing them on the budget, on the other hand, seem to owe more to the introduction of MTEFs. This is a slow process but the situation is improving. In addition, the existence of top-down sectoral ceilings also seems to have injected some stability and predictability in the flow of resources coming from the general budget.

### Notes

1. All data in this chapter are provided in current international dollars, purchasing power parity.
2. Total public domestic expenditure include total expenditure for environmental pollution control (investment + current) + public expenditure on natural resource management + public expenditure on research and development.

### Selected sources

Russian Statistical Institute (2010), *2010 Statistical Yearbook of the Commonwealth of Independent States*, Russian Statistical Institute, Moscow.

## *Chapter 4*

### **Budget planning and management practices**

*This chapter looks into issues related to budget planning and formulation and their actual implementation in the EECCA countries. A special focus is placed on the role of the legislature in this process. In addition, the chapter discusses the survey results related to medium-term budgeting practices and their linkages to the annual budgets in the countries. Some budget execution practices are discussed in the next chapter through the example of the environmental sector.*

## Budget planning and formulation

The budget process can be divided into four distinct stages: (1) executive drafting or formulation; (2) legislative approval; (3) execution; and (4) audit and evaluation. The timing of the budget process reflects country-specific factors, such as administrative heritage and capacity, the balance of power between the different branches of government, as well as the macro-economic context.

A sound budget formulation process requires, among others, the preparation of robust macroeconomic and fiscal projections, setting fiscal rules, aggregate limits and sectoral expenditure ceilings, the introduction of comprehensive medium-term expenditure frameworks and performance indicators to measure budget execution as well as the integration of capital and recurrent budgets. Below we discuss the results from the survey related to some of these issues.

### *Macroeconomic and fiscal forecasts*

The development of sound conservative macroeconomic forecasts for budget formulation is crucial. Most governments identify, at a minimum, pessimistic and optimistic scenarios (in the Russian Federation, there are three scenarios – pessimistic, realistic and optimistic). Being optimistic, which serves primarily a political purpose, is likely to lead to excessive spending relative to likely revenues as well as to higher deficits and debt. Good practices show that comparing government estimates to estimates prepared by economic researchers from private sector institutions or non-governmental organisations (and using consumer confidence surveys) usually provide a more realistic picture.<sup>1</sup>

The central budget authority in all surveyed countries is the ministry of finance. Ministries of finance are responsible for both the forecasting of fiscal projections and revenue collection (usually through their treasuries) and public finance administration. It is usually ministries of economy which are responsible for long-term macroeconomic projections, such as GDP, inflation rate, share of public debt, exchange rates. These are important elements that ministries of environment need to be aware of when they prepare their programmes and budgets. It is the responsibility of ministries of finance to provide all government agencies with this information regularly and on time in order to ensure consistency in expenditure estimates and financial analysis.

Most EECCA countries prepare medium macroeconomic and fiscal projections. In the absence of a full-fledged MTEF, the existence of such projections shows some rudimentary medium-term budgetary planning. How robust and realistic such projections are it is difficult to say but the recent financial crisis showed the poor predictions of the numbers that governments had calculated in this context.

The most common practice, as reported by the countries, in preparing and publishing such forecasts is on an annual basis; six out of the ten surveyed countries do so (Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova). Only one country publishes its macroeconomic projections three times a year, the Russian Federation and these projections can be found on the website of the Ministry of Economic Development. In the case of the Kyrgyz Republic, since the beginning of 2011, the Ministry of Finance has launched a site where it invites citizens and citizens' organisations to participate in the discussion of the next annual budget. Three countries state that they do not publish such forecasts (Belarus, Ukraine and Uzbekistan). Not publishing such projections does not necessarily mean that they are not prepared but it shows a certain lack of transparency as



well as implies potential difficulties for sectoral ministries and agencies with obtaining this information. In addition, even if such projections exist, if they are not taken into account in the budget preparation process, they remain a futile exercise. This may additionally undermine the credibility of budget formulation.

For example, in Ukraine, often, between the first and the third reading of the draft law on the budget, it is a usual practice that the parliament would change significantly the fiscal indicators. When the crisis hit, even making such projections was (temporarily) suspended. Such macroeconomic forecasts do not allow the preparation of credible fiscal projections and the imposition of a top-down hard budget constraint that can guide the overall levels of spending over the medium-term.

Some of the market-based instruments applied by the EECCA environmental authorities in their policies, namely pollution and natural resource charges, fines and fees, are also revenue-generating and participate in the fiscal projections of the government. In a number of EECCA countries, this revenue goes to the general budget of the countries, in others, it is earmarked to environmental activities and is usually channeled to the existing environmental funds (*e.g.* the Kyrgyz Republic, Uzbekistan). In Ukraine, for example, the ministry of environment works closely with the ministry of finance in estimating expected revenue from pollution charges. This is a good practice as it allows the two institutions to join forces. In addition, the ministry of environment can benefit from access to the tax registrar of the ministry of finance and obtain a better picture of all small and medium-size enterprises and potential polluters that need to be monitored for compliance with environmental legislation.

In some EECCA countries, environmental inspectorates have direct responsibilities for collecting pollution charges, and particularly, fines, even though the revenue they generate goes to the state budget. There are often “plans” for the collection of fines and the ministries of finance closely monitor and enforce their implementation. Such plans may often create perverse incentives for environmental inspectors to focus more on achieving fiscal objectives rather than environmental outcomes.

It is also important to mention how countries deal with expenditure projections reflected in the distinction made in the annual budgets between on-going and new policies/programmes, which is a cornerstone of the MTEF process. Five countries state that such a distinction is clearly made, namely Azerbaijan, Georgia, Kazakhstan, the Russian Federation and Uzbekistan. Moldova reports that this is done but not consistently, while there is no such distinction in the budget in Belarus and Ukraine. In Armenia, for example, the annual budget law does not separately show the new vs. existing initiatives. However, the MTEF does. First, the sectoral ministries must specify the new initiatives separately (with separate justification requirements), and then these are reflected in the final MTEF paper (including for the environmental sector).<sup>2</sup>

### ***Fiscal rules***

The use of fiscal rules is usually associated with improved fiscal performance. Since the pioneering Fiscal Responsibilities Act in New Zealand in 1994, there has been an explosion of interest internationally in fiscal transparency, fiscal rules and institutional arrangements to constrain short-term fiscal opportunism by governments. The European Union fiscal rules have had a huge influence on these developments.

Fiscal rules are institutional mechanisms aimed at supporting fiscal credibility and discipline. More generally, they provide a tool for controlling the budget on both the

revenue and expenditure side. While longstanding experience with rules concerns mainly advanced economies, there has been an increasing interest from emerging and transition economies in these rules. A fiscal rule is defined as a permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates. Box 4.1 presents a short description of the major types of fiscal policy rules in use.

#### Box 4.1. Major types of fiscal policy rules

1. Balanced budget or deficit rules. These include: (i) balance between government revenue and expenditure (*i.e.* prohibition on government borrowing) or limit on government deficit as a proportion of GDP; (ii) balance between structural (or cyclically adjusted) revenue and expenditure, or limit on structural (or cyclically adjusted) deficit as a proportion of GDP; and (iii) balance between current revenue and current expenditure (*i.e.* borrowing permitted only to finance capital expenditure).
2. Borrowing rules. These include: (i) prohibition on government borrowing from domestic sources; (ii) prohibition on government borrowing from central bank, or limit on such borrowing as a proportion of past government revenue or expenditure.
3. Debt or reserve rules. These include: (i) limit on stock of gross (or net) public debt as a proportion of GDP; (ii) target stock of reserves of extra-budgetary contingency funds (*e.g.* social security funds) as a proportion of annual benefit payments.
4. Expenditure rules. These include permanent limits on total, primary, or current spending in absolute terms, growth rates, or in percentage of GDP.
5. Revenue rules. These cover ceilings or floors on revenues aimed at boosting revenue collection and/or preventing an excessive tax burden.

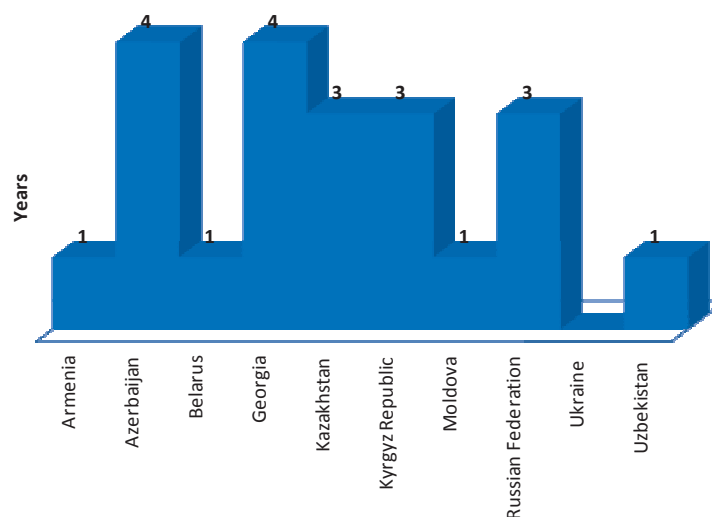
*Source:* IMF, 2010.

What does the survey tell us about the use of fiscal rules in the EECCA countries? First, the EECCA countries have been using fiscal rules for a while. Table 4.1 shows that in an attempt to strengthen fiscal discipline and ensure debt sustainability, the EECCA countries have started using most of the major rules, with the expenditure rule being the most popular (most often the rule targets nominal expenditure ceilings), followed by the deficit rule. Only Ukraine states that there are no fiscal rules apply in the country. In addition, six out of ten countries report that they are subject to fiscal targets set by international financing institutions (IFIs) (most often by the International Monetary Fund (IMF) but the countries do not specify what these rules are (except Kazakhstan). It is likely (as confirmed by Kazakhstan) that the introduction of the fiscal rules in the EECCA countries is also closely linked with the IFIs' fiscal and budgetary requirements.

**Table 4.1. Are there fiscal rules that place limits on fiscal policy?**

Country	No limits	Yes, expenditure rule	Yes, revenue rule	Yes, budget balance (surplus/deficit rule)	Yes, debt rule
Armenia		•		•	•
Azerbaijan		•		•	
Belarus		•		•	•
Georgia		•			
Kazakhstan				•	
Kyrgyz Republic				•	•
Moldova		•		•	
Russian Federation		•	•	•	•
Ukraine	•				
Uzbekistan		•	•	•	•

The time horizon covered by the fiscal rules varies between one and four years and the rules are established in the budgetary legislation (see Figure 4.1). It is difficult to say, on the basis of the survey only, what exactly is the experience of the EECCA countries with the implementation of these fiscal rules or what their impact is on fiscal stability and debt sustainability of EECCA economies.

**Figure 4.1. Time horizon of fiscal rules, number of years**

The experience with using fiscal rules worldwide is somewhat mixed. At the outbreak of the financial crisis, many countries broke their rules, including in the EECCA region and in the European Union region, for that matter. Several concerns arise regarding rule-based fiscal policy. First, rules adopted without a sufficient political commitment to pursue a disciplined policy or without necessary prerequisites adequately in place are unlikely to be sustained and may end up undermining policy credibility. Second, rules – especially deficit and debt ceilings – may entail a pro-cyclical stance<sup>3</sup> in bad times as they constrain discretion (and in good times they may not be binding). Third, rules may reduce the quality of fiscal policy because they are generally silent on the composition of the eventual fiscal adjustment needed to comply with the rule. This may result in easy-to-cut capital spending that may have high social returns with potential negative impact on long-term growth prospects. Fourth, rules can encourage “creative” accounting and off-budget operations to be seen abiding by the rule, thus reducing transparency. This temptation is likely to be all the greater in an environment of large deficits and debts, and sustainability concerns.<sup>4</sup>

### *Expenditure ceilings*

Ministries of finance have the leading role in maintaining aggregate fiscal discipline, ensuring compliance with the budget laws and enforcing effective control of budgetary expenditure. Giving a hard constraint to sectoral ministries from the beginning of the budget preparation process favours a shift from a “needs” mentality to an availability mentality. In most countries, there is some form of top-down budgeting, including fixed limits for initial ministries’ spending plans (see Table 4.2). These limits may be fixed annually or on a medium-term basis.

Six out of ten countries report that there are fixed limits for the initial ministries’ spending plans based on the medium-term expenditure framework (Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation). Belarus reports that such limits are given in the form of suggested spending targets only. Kazakhstan and Uzbekistan report that there are no such restrictions, while Ukraine reports no medium-term limits on expenditure but they actually have annual limits (both on capital and recurrent budgets). Setting sectoral expenditure ceilings, based on medium-term

expenditure projections, is a good practice. However, if the medium-term sectoral expenditure projections are not robust, the entire exercise of setting sectoral ceilings will not be credible.

**Table 4.2. Are there fixed limits on a ministry's initial budget proposals for upcoming year?**

Country	There are no medium-term plans of budget expenditures	Yes, they are based on the medium-term expenditure framework	No, there are only suggested spending targets	No, there are no restrictions on initial budget proposals from ministries
Armenia		•		
Azerbaijan		•		
Belarus			•	
Georgia		•		
Kazakhstan				•
Kyrgyz Republic		•		
Moldova		•		
Russian Federation		•		
Ukraine	•			
Uzbekistan				•

Expenditure ceilings are not cast in stone, in most cases they are indicative and provide sector ministries with some basis from which they can start preparing their medium-term and annual budget plans. These ceilings may change for various reasons (economic changes, new policy initiatives and the need for the reallocation of resources). The existence of some indication, even if not completely precise, is better than the lack of any such ceilings. As stated earlier, it is generally agreed, that the only hard expenditure ceilings are those for the current year of the MTEF, which constitute the start of a sound budget preparation process. At the same time, the sector ceilings for the out-years should not merely be loose and casual indications either, to be readily ignored when the annual budget process comes around again, otherwise the whole process risks to lose credibility.

Apart from expenditure ceilings, ministries of finance use other instruments to guide the budget preparation process in the sectors. As can be seen in Table 4.3, in all surveyed countries, ministries of finance issue, annually, a set of rules for the budget process, sectoral ministries receive a set of macroeconomic assumptions to be used in the budget preparation process and in seven of the countries sectoral ministries are given explicit information on government priorities as guidance in the process.

**Table 4.3. What information is contained in annual budget regulations issued by ministries of finance?**

Country	A set of rules for the budget process and the main forms to be used in the estimates submission	The macroeconomic assumptions to be used in the process	Information on government priorities	Spending ceilings or targets
Armenia	•	•	•	•
Azerbaijan	•	•	•	•
Belarus	•	•		•
Georgia	•	•	•	
Kazakhstan	•	•		•
Kyrgyz Republic	•	•		•
Moldova	•	•	•	•
Russian Federation	•	•	•	•
Ukraine	•	•	•	
Uzbekistan	•	•	•	

### *Capital and recurrent budgets*

Another element in the budget formulation process is the preparation of capital and recurrent budgets. As the survey shows, in four of the countries, the two budgets are prepared separately and split presentationally in the central budget (Azerbaijan, Kazakhstan, the Kyrgyz Republic and Ukraine). In the Kyrgyz Republic, for example, the parliament approves only the capital budget. The two budgets are integrated in four of the countries (Armenia, Georgia, Moldova, the Russian Federation), and in Belarus and Uzbekistan, the two budgets are put together but they are presentationally sub-divided in the central budget (Table 4.4). In Armenia, more specifically, which is in a process of moving to programme budgeting, the capital appropriations are presented as part of a programme together with recurrent appropriations, thus indicating the full costs (on a cash basis) of the programme.

The process of preparing the two budgets separately by two different entities is known as dual budgeting. Initially this practice was introduced with the aim of applying the “golden rule” in public finance policy which would require balancing the recurrent budget and borrowing only for investment. Experience shows that often when two separate institutions prepare the two budgets, they do this by using different criteria, different staff and even different ideologies. Clearly, such a practice impedes the integrated review of current and investment expenditure that is necessary for any good budget process.

**Table 4.4. Is your central government budget split into a separate capital and recurrent budget?**

Country	No, capital and operating budgets are integrated	One budget is formed, but it is sub-divided into current and capital expenditures	Yes, there are separate capital and operating budgets
Armenia	•		
Azerbaijan			•
Belarus		•	
Georgia	•		
Kazakhstan			•
Kyrgyz Republic			•
Moldova	•		
Russian Federation	•		
Ukraine			•
Uzbekistan		•	

Preparing the two budgets separately is not in line with good international practices (for presentational purposes, however, they may still be shown separately). Estimating the costs of investment programmes separately from their operation and maintenance (O&M) costs provides a misleading picture of the future public funds needed for the adequate maintenance of capital assets. This budget structure also goes against the rationale of the programme-based approach of grouping all relevant costs together. With further improvements in the budgeting process, countries will have less need for such a split.

### *Medium-term expenditure frameworks*

The survey shows that most of the countries in the region have already introduced MTEFs. As Table 4.5 shows, seven of the countries have MTEFs, Belarus is planning to launch its first MTEF in 2011, Ukraine and Uzbekistan do not yet have MTEFs. Armenia was the first to introduce this budgeting approach – this happened as early as 1999. It is interesting to point out that while Ukraine does not have a fully-fledged MTEF, analysis carried out by the OECD in this country shows that there are certain elements that belong to the MTEF concept, already in place in Ukraine (*e.g.* medium-term fiscal projections, a kind of two-year expenditure plans required by the legislature from sectoral ministries). It is also interesting to note that the Russian Federation has gone a step further and has launched the adoption of not just a three-year MTEF but actually of three-year budgets. This practice was however suspended at the face of the financial crisis and only recently resumed.

In terms of MTEF coverage, five countries report full coverage (Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation), that is, all levels of government are included in the MTEF, both Armenia and Azerbaijan report that the MTEF applies to central government bodies only (excluding local governments<sup>5</sup>). The same five countries plus Azerbaijan report that from the outset, the MTEF was introduced as a

whole-of-government exercise. The MTEFs in these countries, except in the Russian Federation, are rolling frameworks revised on an annual basis. In the Russian Federation, it is rather a fixed or periodical three-year budget (at least this is the intention).

**Table 4.5. Is there a medium-term expenditure framework (MTEF)?**

Country	MTEF	Year of launching the MTEF	Number of years of the MTEF
Armenia	Yes	1999	3
Azerbaijan	Yes	2003	4
Belarus	No	Expected 2011	N/A
Georgia	Yes	2005	4
Kazakhstan	Yes	2008	3 (plans for a 5 year MTEF)
Kyrgyz Republic	Yes	2001	3
Moldova	Yes	2002	3
Russian Federation	Yes	2006	3
Ukraine	No, only certain elements	N/A	N/A
Uzbekistan	No	N/A	N/A

It is interesting to note that the one and only reason for introducing the MTEF, as reported by the countries, was the enhancement of medium-term planning in the individual sectors. While this is a legitimate concern, it differs from the situation in the OECD countries which did that primarily to fight high fiscal deficits and to restore fiscal discipline. A possible explanation for this specific situation in the EECCA countries is the fact that MTEFs were introduced in a period when most countries were enjoying high economic growth and often budget surpluses. It seems that the EECCA countries chose to introduce MTEFs rather as a tool of improving their financial planning capacities. On the other hand, the situation in the EECCA region may also reflect the fact that most countries launched MTEFs with support of donors and international organisations. All countries, except Azerbaijan, report such support for the MTEF development. As part of their support, a number of donors have required the introduction of medium-term expenditure frameworks. This may also have been the case in some of the EECCA countries.

In addition, all countries, but Armenia, report that the MTEF document is presented together with the annual budget in the parliament when annual budgets are discussed. In Armenia, the MTEF paper is submitted to the Parliament three months before the draft budget law so that members of parliament (MPs) have sufficient time to review the government medium-term expenditure plans. All countries also report that the structure of the MTEF document and the annual budget are identical. In terms of the nature of expenditure estimates included in the MTEF document for the years beyond the current budget year, Georgia reports that these are loose estimates, Azerbaijan, the Kyrgyz Republic and Moldova report that these represent indicative allocations of funds to an agency or programme. It is interesting to note that not only the Russian Federation, but also Kazakhstan, state that these are binding forward budgets, including new policy proposals. This statement by Kazakhstan seems to indicate that the country may have chosen to follow



the Russian model. At the same time, only Armenia, Azerbaijan, Kazakhstan and Moldova report that the first out-year of the MTEF is automatically used as a starting point for the preparation of the next year budget.

In Armenia, for example, the methodological instructions for the MTEF and budget request formulation (it is one instruction for both submissions) state that budget submissions from sectoral ministries may vary from the ceilings only if some legislative changes and/or other exogenous factors occurred in the time between the moment the MTEF ceilings were set and the actual budget submissions made. Besides, the same instructions state that during the budget submissions, sectoral ministries are allowed to make changes in the proposed budgets of the programmes, provided these changes do not exceed the ceiling set for the agency.

It is difficult to judge on the basis of the survey alone how the MTEF document is treated by the MPs or what its quality is. It seems that in general, MTEF estimates do not require authorisation by the legislature, the MTEF document is usually presented for illustration and information purposes only. Except, of course, in the Russian Federation where the MTEF is supposed to have a different status of a three-year budget, and not just a framework. In this case, the approval of the legislature is constitutionally required (see Table 4.6).

**Table 4.6. Nature of MTEF out-year expenditure estimates**

Country	Binding forward budget, including new proposals	Indicative allocations of funds to a sector / agency / programmes for the MTEF period	Loose cost of existing policies/programmes identified for the MTEF period	N/A
Armenia		•		
Azerbaijan		•		
Belarus				•
Georgia			•	
Kazakhstan	•			
Kyrgyz Republic		•		
Moldova		•		
Russian Federation	•			
Ukraine				•
Uzbekistan				•

Given that a fully-fledged MTEF requires budgets organised around programmes, it is interesting to see to what extent programme budget classification is used by the countries. Traditionally, the allocation of budget expenditure in the EECCA countries is most often done on the basis of economic and functional classifications. More recently, programme classification of expenditure was added to the budgets. Budget programme classification is a major issue and often poses challenges to successfully integrating it with existing classifications.

As seen in Table 4.7, almost all countries use all types of existing budget classifications but programme classification is gaining grounds. Of the ten countries, Georgia, the Kyrgyz Republic and Uzbekistan do not use programme classification in their budgets. It is interesting to note that Georgia reports only one type of budget classification used in the country's budget, that is the separation of capital and current expenditure, as part of line-item classification. This seems to be somewhat contradictory to what Georgia reports, earlier in the survey, with regard to the integration of the capital and recurrent budgets.

**Table 4.7. How expenditure are classified in the central government budget**

Country	Function / sector classification (e.g. environment, health, defence)	Economic classification (e.g. employee compensation, interest grants)	Line-item (or object) classification for procurement of goods and services (e.g. salaries, travel, printing)	Separation of current / capital expenditure (as part of line-item classification)	Administrative or organisational classification (e.g. hierarchical levels and administrative units in line ministries)	Programme classification (reflecting the government's policy objectives and/or individual programme budgets)
Armenia	•	•	•	•	•	•
Azerbaijan	•	•	•	•	•	•
Belarus	•	•	•	•	•	•
Georgia				•		
Kazakhstan	•	•	•	•	•	•
Kyrgyz Republic	•	•	•	•	•	
Moldova	•	•	•	•	•	•
Russian Federation	•	•	•			•
Ukraine		•	•	•		•
Uzbekistan	•	•	•	•	•	

Programme budgeting is the practice of grouping different kinds of budgetary expenditure into separate programmes so that every type of expenditure can be linked directly to one or another programme. Programme-based budgeting implies that expenditures are presented in the form of programmes in the annual budget. Unlike traditional practices of formulating budgets that usually focus on inputs of the public sector

production function and frequently pay little attention to the nature of the outputs that are produced, programme-based budgeting reverses the process focusing, first, on outputs and outcomes and only then asking what is the adequate level of resources needed to produce these outputs. In this sense, programme-budgeting is concerned with achieving results and suggests the use of performance indicators to measure the attainment of the programme's objectives. In this context, programme and performance-based budgeting are closely linked in spirit.

### ***Performance information in the budget process***

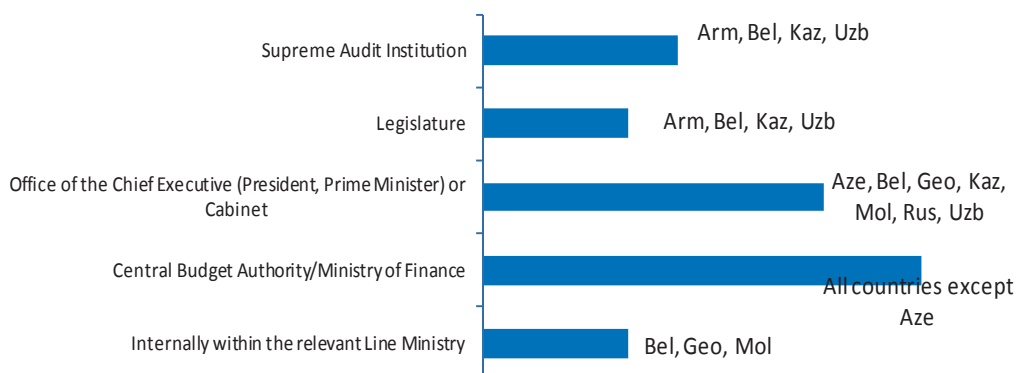
Over the past years, as part of the efforts to improve public sector performance and accountability, many EECCA countries have sought to introduce performance information into their management and budgeting systems. Countries are at different stages of developing their performance systems. All countries report that all ministries and government agencies are required to set some performance targets (either financial and/or non-financial) in their MTEF/budgetary documentation.

In terms of responsibilities for setting performance targets for sectoral ministries, five countries (Armenia, the Kyrgyz Republic, Moldova, the Russian Federation and Uzbekistan) report that it is the respective minister who bears this responsibility. In Azerbaijan and Georgia, it is the minister of finance jointly with the respective sectoral minister, and in Belarus and Kazakhstan – it is the Office of the Chief Executive (president/prime minister or cabinet of ministers). Responsibilities for achieving the performance targets are borne by approximately the same institutions/people.

Performance measures (outputs or outcome measures) and evaluations are the methods most commonly used to assess the performance of agencies and programmes. Benchmarking is practically not used. *Ex post* evaluation of target achievement is also usually carried out by sectoral ministers, or the president/prime minister/cabinet of ministers (Azerbaijan and Kazakhstan) and only Georgia reports that this is jointly done by the minister of finance and the respective sectoral minister.

Setting targets and evaluation of the results can be a very formal (or formalistic) process and it is difficult, on the basis of the survey only, to judge the quality of this exercise. It is more interesting however to see how all this information is used in practice both in sectoral ministries, in the ministry of finance, in the parliament and in the public debate, as a whole.

Usually, this information is used to hold the sectoral minister accountable for results and, second, in the debate between the sectoral ministry and the ministry of finance on allocation of resources. While all countries prepare both financial and non-financial performance information, in Azerbaijan, the Kyrgyz Republic and the Russian Federation, non-financial targets do not have place in budget negotiations with the ministries of finance. Non-financial information is also provided to other relevant institutions, such as the supreme audit institution, the legislature, office of the president/prime minister/cabinet of ministers as well as distributed internally within sectoral ministries. There are two interesting facts to note in the countries' responses in this regard. First, only four countries, Armenia, Belarus, Kazakhstan and Uzbekistan, state that such information is presented to parliament, and three countries, Belarus, Georgia and Moldova, state that this information is provided internally to sectoral ministries' staff (Figure 4.2). In Uzbekistan, such information is also provided to the cabinet of ministers and the president's cabinet.

**Figure 4.2. Reporting of non-financial performance information to various bodies**

With regard to providing performance information to parliament, Azerbaijan and Belarus state that this is done rather on an *ad hoc* basis and if specifically requested, and only Armenia and Kazakhstan report that each ministry prepares performance reports accompanying the budget. But no country, except Armenia, reports using performance information in the main budget documents. In the case of Armenia, in budget formulation, performance information on non-financial indicators goes to parliament for all agencies' budgets by all programmes and sub-programmes, the indicators may not be the ideal ones, but they exist. As for budget reporting, all agencies provide quarterly reports to the Ministry of Finance, but the Ministry of Finance provides information to parliament on non-financial indicators of government agencies' performance but only on an annual basis. Currently, the Ministry of Finance edits these reports before sending them to parliament, thus the reports become less comprehensive focusing only on "big" programmes and/or "big" deviations from the plans.

Performance information is also provided to the public at large. Most commonly, it is presented as part of government-wide reports on performance, followed by information provided on ministries' websites (see Table 4.8). While websites are an easy way to check a ministry's performance, government-wide reports are not a particularly good option for the general public to understand the performance of a given agency. Either because, such reports are not readily available to the public at large or because the necessary information is not always easily identifiable.

Some of the countries that have moved to programme budgeting and programme budget classification have tried to use cost information more consistently in budget debate. For example, in Armenia, over the last three-four years, such information has been presented to parliament as part of the budget message (but not as an annex to the budget law). After the approval of the annual budget law, the government approves the programme classification documents by quarters and uses them for internal monitoring and reporting on non-financial performance. This solution has been used to facilitate the transition from the old inputs-based classifications to the new programme-based classifications.

**Table 4.8. Is performance against targets made available to the public?**

Country	Yes, a Government-wide report on performance is published	Yes, individual ministries publish reports on their performance	Yes, as part of other Government-wide documents	Yes, as part of other ministry-specific documents	Yes, there is an internet site for this information
Armenia	•	•	•		•
Azerbaijan	•			•	
Belarus			•		•
Georgia		•			•
Kazakhstan	•	•	•	•	•
Kyrgyz Republic			•		
Moldova			•		
Russian Federation			•		
Ukraine	•			•	•
Uzbekistan	•				

It is interesting to note how OECD ministries of finance and legislatures use performance information in the budget process. The majority of OECD countries engage in performance informed budgeting. That is, they use performance information in budget negotiations along with other information on fiscal factors and political priorities. Performance information is one factor in the decision-making process and it is generally used to inform – but not to determine – budget allocations (OECD, 2007b). The current practice, on a government-wide scale, in OECD countries is not to automatically or mechanically link funding to results. It is questionable if such an approach is even desirable at this level given the technical issues and questions of incentives involved with adopting it.

In addition, OECD experience with setting performance targets and indicators shows that the process by which performance targets are set is as important as the targets themselves. A lot of valuable learning actually comes from such “performance dialogues”. Also, in many OECD countries, when ministries and government agencies submit performance targets, they must also specify data sources of the information and the methodology used for determining the targets. Much importance is placed on cost efficiency of performance measures, to make sure that the costs of analysing and evaluating performance do not outweigh the benefit of performance information (see Box 4.2).

The experience of the OECD countries has shown that having a procedure to integrate performance information into the budget process is a necessary but not sufficient condition to ensure its use in budgetary decision making. Other factors that also influence the use of performance indicators include: the institutional capacity of the ministries of finance and spending ministries; the quality of the performance information; and the political and economic environment that creates demand for such information.

#### **Box 4.2. Integration of financial and performance information in the Dutch budget**

The Dutch budget system was reformed in 1999. The principal goal of the reform was to reinstitute the fundamental “link” between policy goals, institutional operations and financial resources. The reform was implemented in two directions: first, the structure and contents of budget documents was changed to incorporate goals and objectives of institutional operations into institutional budget documents, and second, institutions were required to deliver annual performance reports and to make the reports public and accessible to all parties concerned. Today, the Dutch budget document incorporates information on the goals and objectives pursued (for a period of four years) and already achieved (in the past two budget years) and the cost of achievement.

Institutional budgets are structured around the following three basic questions:

- 1) What do we want to achieve?
- 2) What we will do to achieve it?
- 3) What will be the costs of our efforts?

Subsequently, at the end of a budget year, institutions and government agencies write performance reports that answer the following questions:

- 1) Have we achieved what we had intended?
- 2) Have we done what we should have done in achieving it?
- 3) Did it cost what we had expected?

To ensure good quality of non-financial information (performance information) presented in the budget document and annual reports, the Dutch Ministry of Finance has issued guidelines about the standard of quality of performance information and measurement of performance. These guidelines were further elaborated in 2006, in the Periodic Evaluation Research and Policy Information Regulation.

*Source:* Adopted from Ernst & Young Baltic and the Public Policy and Management Institute (2010).

Similar to the OECD countries, the EECCA countries are struggling with performance information. While performance budgeting is gaining grounds as part of the budgeting process, performance information, particularly non-financial, is rarely used in budget and broader policy debates on priorities in the EECCA region. The legislature in most of the EECCA countries is still not interested in performance. There is no real demand for performance information at this stage, and performance budgeting and target setting seem to be more of a fashion than a real need in these countries.

## Budget approval and the role of the legislature

Most EECCA countries have reformed their budget institutions and introduced new comprehensive Budget Laws and/or Budget Codes. The legal framework is established not only by the Budget Codes, but also by the Constitution, the Annual Budget Law and other internal regulations, such as regulations on what happens when the budget is not approved by the beginning of the fiscal year, or what needs to be done when emergency situations occur. The legislature is central to all these budget issues.

For the sake of our analysis, the legislature is also important because it makes the final decisions on the allocation of resources across sectors. So, we would primarily like to know how the legislature makes these decisions and what kind of support it uses in its deliberations.

In all EECCA countries, the central budget authority is located at the Ministry of Finance. In most countries, the office of the President or the Prime Minister is closely involved in the approval of the budget.

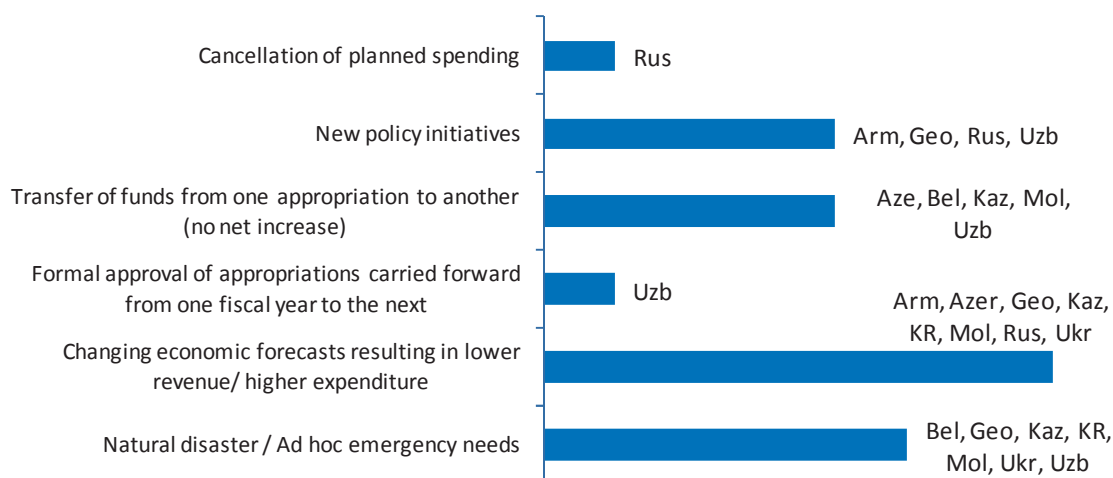
Usually, the country's constitution creates the political system and the macro-institutional framework, which sets the parameters of the relationship between the legislature and the executive. The formal role of the legislature in the budget process depends on the nature of executive-legislative relationships, which in turn is influenced by the characteristic of the party and electoral systems. The EECCA countries have a diverse system of government, ranging from parliamentary democracy (in the Kyrgyz Republic, Moldova), presidential republic in Azerbaijan and Uzbekistan, supra-presidential (extremely strong powers for the president) in Belarus, semi-presidential in Ukraine, a federation in the Russian Federation, and a hybrid system (both presidential and parliamentary) in Kazakhstan. It seems that, in general, the legislature in most EECCA countries have a strong role in the budget process which is exemplified by the right of the legislature to make changes in the detailed budget proposed by the executive. This happens in four of the countries, namely Azerbaijan, Georgia, the Russian Federation and Ukraine. In the other countries, modifications are still possible on the condition that there is no net change in the total budget deficit/surplus levels. Armenia is the only country where the legislature cannot make any changes in the budget proposed by the executive (Table 4.9).

**Table 4.9. Forms of restrictions on the legislature to modify detailed budgets proposed by the executive**

Country	Legislature may not make any changes, it can only approve or reject the budget as a whole	Legislature may reallocate or increase funding levels but only if it reduces others or approves new revenue sources, <i>i.e.</i> no net change in total deficit/surplus	Legislature may create new spending items but only if it reduces others or approves new revenue sources, <i>i.e.</i> no net change in total deficit/surplus	Legislature is not restricted in its ability to modify the executive budget proposal
Armenia	•			
Azerbaijan				•
Belarus		•		
Georgia				•
Kazakhstan		•		
Kyrgyz Republic		• (very rarely used)		
Moldova		•	•	
Russian Federation				•
Ukraine				•
Uzbekistan		•		

Of course, while the legislature may be legally entitled to make changes to the budget that does not mean that, in practice, such changes are always made. However, in the 2007 and 2008 fiscal years, all EECCA countries, except Armenia (in 2008), had to modify their budgets and adopt supplementary budgets. The Russian Federation did this 5 times. The reasons most often quoted by the countries for these supplementary budgets are changes in the economic situation, followed by natural disasters (see Figure 4.3). These legislative amendments to the budget raise concerns about effective budget execution by individual ministries. For example, as a result of such budget modifications, the budget of the Ukrainian Ministry of Environment, was reduced by more than 30% by the end of 2008 compared with initial budget commitments. This hindered significantly the implementation of the ministry's programmes. And among all ministries in Ukraine, the Ministry of Environment suffered one of the largest cuts in the government.



**Figure 4.3. What are the main factors requiring supplementary budgets?**

While parliaments in most countries in the world have the constitutional right to change the budget proposed by the executive, the question is on what basis such decisions are made. In many countries, the legislature can only make changes in spending if the overall deficit or surplus is not altered, for example. Sixty per cent of the surveyed countries do this as well but in the other 40% the rules for the legislature in approving budgets are not very clear. Anecdotal evidence has it that in the countries with strong presidential functions the actual budget decisions are not always taken in the legislature. In such countries, the legislature acts more as an executor rather than as a taker of decisions. Table 4.10 provides an example of the number of changes to the annual Budget Law of Ukraine over the period 2006-10 and the source of the proposed changes. Most of these changes come from MPs, followed by the Cabinet of Ministers and the President.

**Table 4.10. Changes to the State Budget Law of Ukraine during the fiscal year in 2006-10\***

Fiscal Year	2006	2007	2008	2009	2010
<b>Total proposed draft laws modifying the Budget Law</b>	<b>11</b>	<b>17</b>	<b>63</b>	<b>43</b>	<b>32</b>
<i>Proposed by Verkhovna Rada (the Parliament of Ukraine)</i>	10	11	51	27	27
<i>Proposed by the President</i>	-	1	4	2	-
<i>Proposed by the Cabinet of Ministers</i>	1	5	8	14	5
<b>Total adopted legislation by the Verkhovna Rada modifying the Budget Law</b>	<b>8</b>	<b>5</b>	<b>9</b>	<b>14</b>	<b>14</b>
<i>Proposed by the Verkhovna Rada</i>	7	-	4	7	9
<i>Proposed by the President</i>	-	-	3	1	-
<i>Proposed by the Cabinet of Ministers</i>	1	5	2	6	5

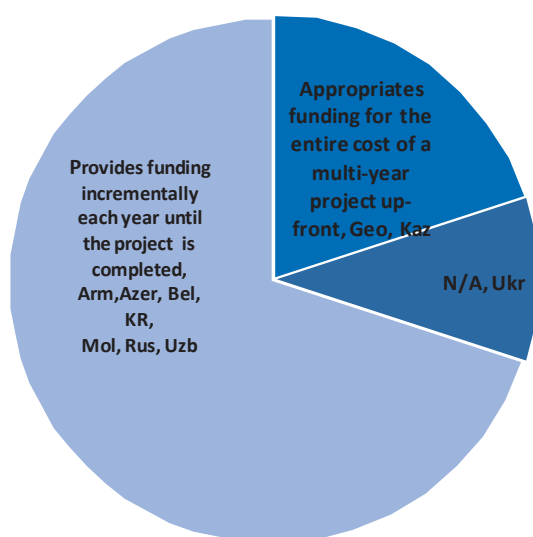
Source: OECD (2011).

Members of parliament are in most part politicians who may not necessarily have sufficient expert knowledge to make informed decisions on resource allocations. To be able to do so, they need additional information and research. We asked a question about this.

What countries' responses show is that in Armenia, Azerbaijan, Belarus and Moldova, parliamentarians have no research resources to carry out their independent analysis. In the rest of the countries, there is either a research office in the legislature that serves all parliamentarians (Kazakhstan, the Russian Federation, Ukraine) or analytical staff are attached to sector committees (Georgia, the Kyrgyz Republic). For information, many OECD countries (*e.g.* Australia, the Netherlands) have large research offices and even institutes which provide analytical support to parliamentarians and help them make better informed judgements.

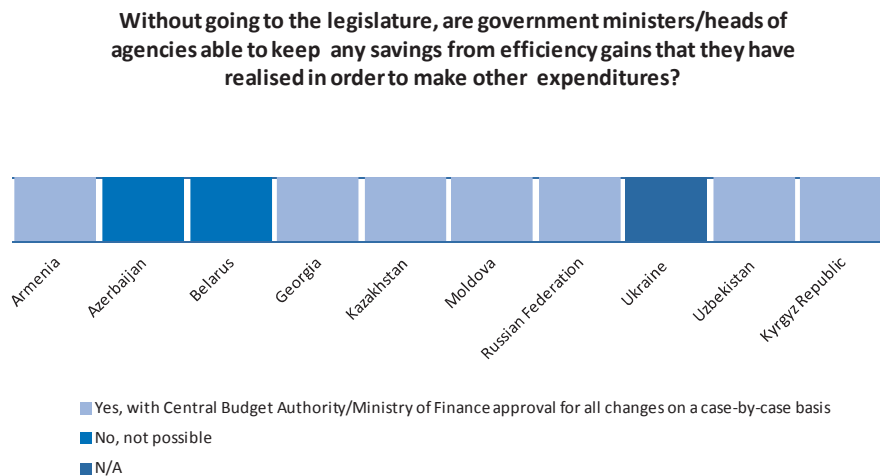
One particular issue of interest related to budget approval is how the legislature approves capital projects that require funding over several years. Seven countries out of ten report that the legislature approves the level of funding on an annual basis until the project is completed, and only two countries, Georgia and Kazakhstan, report that the legislature appropriates the entire funding for the multi-year project as of the first year of approval (Figure 4.4). This is most likely done in the framework of the Public Investment Programmes where these exist. Ukraine has not responded to this question but it is likely that the traditional annual appropriations apply there as well. As analysis of Ukraine shows, allocating budget resources on an annual basis may often creates difficulties with project implementation as the membership of parliaments change throughout the years and if resources are not committed at the outset, money may not be made available in the subsequent years by the new parliament. This is a common case, and many countries face similar situations.

**Figure 4.4. Approval of multi-year capital projects by the legislature**



In terms of budget execution, most countries (except Azerbaijan, Belarus and Ukraine) confirm that ministries' heads are allowed to keep savings that they have realised within their budgets and reallocate them for expenditure which were different from those that have been envisaged initially in the budget (Figure 4.5). And this can be done without asking the legislature to authorise such reallocations of efficiency gains. This is an important improvement particularly in the framework of medium-term expenditure frameworks as it injects a level of flexibility in the execution of the individual ministries' budgets and gives a better sense of ownership to government agencies in making spending decisions. However, without a proper budget scrutiny and audit systems in place, this practice may also create some risks of over-estimating programme costs.

**Figure 4.5. Reallocation of efficiency savings by sectoral ministries**

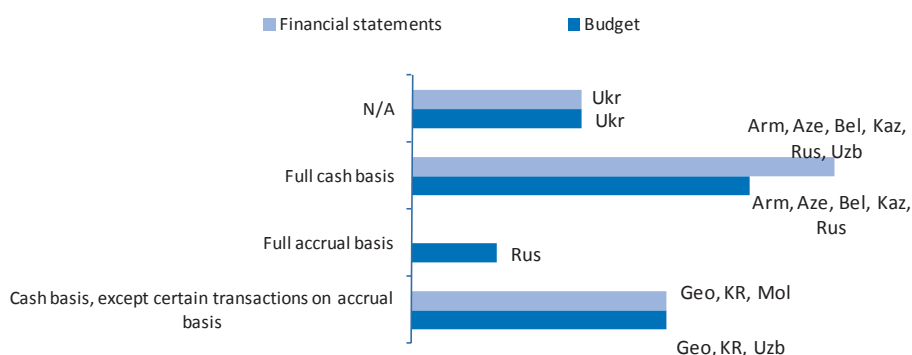


## Budget transparency

Transparency of budgetary entities is usually ensured through regular reporting (financial and non-financial), accounting and auditing. All countries usually prepare financial reports at the end of the fiscal year (a busy period for the financial departments in sectoral ministries). Sectoral ministries are also required to prepare non-financial reports as well. We did not ask a specific question on this issue but from our experience (*e.g.* Ukraine) we know that these reports rarely contain detailed explanations on public expenditure or, alternatively, they are overloaded with data, which does not facilitate the user's understanding. Generally, information on results of environmental public expenditure is somewhat of a taboo. It is not easy to find such information on ministries' (of environment) websites. As such, it is not clear what is exactly achieved with all the money spent. Financial statements are not easy to understand for non-specialists and there is a need to prepare more informative, even general public-friendly, reports. In the case of Armenia, where all sectoral ministries are required to prepare quarterly and annual monitoring reports on performance, for all programmes and sub-programmes they manage, detailed information is presented to the Ministry of Finance only. Access to that information is available only if data are officially requested from the Ministry of Finance.

In terms of accounting, full cash basis is the most common method for presenting both the budget document and the financial statements of the government to the legislature (see Figure 4.6). Only the Russian Federation prepares its budget documentation on an accrual basis. Accrual basis implies the accounting of not only cash transactions of the budgets but also commitments in receivables and payables. While, generally, this is the preferred accounting method, as it reveals the true financial health of economic entities, very few, even OECD countries, would use it in their budget documents. This method is usually used in the private sector but rarely in the public sector budget and financial statements. It is not easy to implement and the fact that the Russian Federation has started using it shows a significant level of advancement in its accounting procedures.

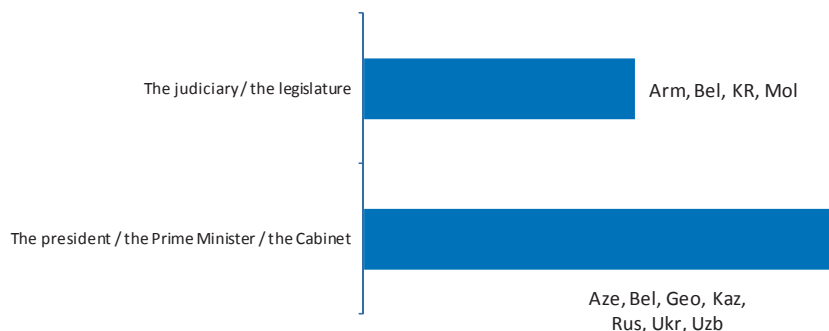
**Figure 4.6. Accounting basis for presenting government budget and financial statements**



Auditing of public entities accounts is a responsibility of some dedicated office. Such auditing institutions exist in most EECCA countries. For example, this function in the Russian Federation is carried out by the Accounts Chamber, in Armenia, by the Control Chamber, in Ukraine, by the State Control Office. These offices are all independent and report to parliament, but often lack the resources to do their job properly.

The Accounting Committee in Kazakhstan reports to the President first, and then to Parliament, which has raised questions about its independence and transparency. The independent audit function is still in the process of being set up in Azerbaijan. As Figure 4.7 shows, in four of the countries (Armenia, Belarus, the Kyrgyz Republic and Moldova), the supreme audit institution principally reports (or provides reports, as in Armenia) to parliament or the judiciary, in six – principally, to president/prime minister/cabinet (Azerbaijan, Georgia, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan) and in Belarus – it reports to all these institutions.

In most countries, ministries are audited at least once a year. However, these reports are rarely available to the general public. In Ukraine, for example, our analysis has shown that the audit office has checked carefully the ministry of environment accounts several times and it has been very open about the irregularities they find there. It turns out that the problem is more on the side of the legislature which does not always take measures when such cases are reported to parliamentarians.

**Figure 4.7. To whom does the supreme budget institution principally report?**

As part of the process of improving the transparency of public expenditure, many EECCA countries have established internal audit units in government institutions, including in environmental ministries. From the countries' responses it becomes clear that only Azerbaijan and Uzbekistan do not have such units in their environmental administrations. Such additional internal control mechanisms help improve budgetary discipline and help work as early warning systems in case of problems.

## Major findings

Altogether, over the past decade, there has been a significant advancement in the reform of the budgetary process in the EECCA countries. New methods and approaches to budgeting have been adopted, new institutions built. To what extent these approaches and institutions are effective and performing is difficult to judge on the basis of the survey only. Many of these reforms still seem to be on paper only, they have not yet been fully institutionalised and as such are susceptible to external shocks. Most importantly, however advance reforms need time to get established as part of societal values and in administrative culture. Even if slowly, countries like the Russian Federation and Armenia, where these reforms are most advanced, show that actual improvements are possible.

The major findings that emerge from this analysis are:

- All countries have carried out basic public finance reforms. These include, among others, the preparation of regular macroeconomic (monthly) and fiscal forecasts (annually), the introduction of fiscal rules to ensure sound budget preparation and execution (nominal annual expenditure ceilings being the most typical ones), consolidation, to a certain extent, of capital and recurrent budgets (particularly, in Georgia, Moldova, the Russian Federation).
- Most EECCA countries have introduced more advanced public finance reforms, such as MTEFs, including on a programmatic basis. Performance budgeting is also gaining grounds. The first country to launch the preparation of a MTEF is Armenia, starting in 1999, with support from donors, and the last countries that have been introducing the MTEF in their budgeting process are Kazakhstan and Belarus. Uzbekistan has not yet introduced a MTEF but there is some indication that the government is looking into this issue and in Ukraine, while there is no fully-fledged medium-term expenditure framework to the budget, there are some elements in the budget process typical of the MTEF philosophy. In all these countries, the MTEFs are rolling frameworks, revisited on an annual basis, except in the Russian Federation, where the MTEF is a periodical three-year budget. This

type of budget is not common even with the OECD countries, thus it will be interesting to learn further from the Russian experience when this model gets institutionalised. Five countries (Georgia, Kazakhstan, the Kyrgyz Republic, Moldova and the Russian Federation) report full coverage of the MTEF, that is it covers all levels of government.

- All countries report that they produce the MTEF document along the same lines as the annual budget and submit both to the parliament. The MTEF cost estimates are not authorised by the legislature, they are mostly for information and illustration.
- Programme budget classification is gaining grounds, including performance information. However, most countries report that this non-financial performance information is rarely used by decision makers in policy debates in parliament on the allocation of resources. If there is no real demand for such information within the government, this can turn into a frustrating exercise for regular staff in the ministries.

## Notes

1. Countries use a variety of techniques to assure sound economic estimates, some during the budget development stage (*ex ante* to budget enactment) and some after budget passage. Among *ex ante* good practices are: comparison with private or academic forecasts during forecasts development, using the median forecasts of several reputable non-government organisations, economic updates prior to the budget enactment that allow for modifications to the budget proposals to fit emerging trends, inclusion in the budget of a table comparing the key economic variables of the government forecast with several reputable private or public forecasts with explanations for significant variation in median forecasts and having multiple government forecasts that could be the basis of budget development. Good practice also includes setting aside “reserves” during budget formulation to account for some variation in forecasts after budget passage, mid-fiscal year economic updates after budget passage combined with required proposals to bring the budget in line with emerging trends during the fiscal year, formal procedures for passing supplemental budgets during the fiscal year. Source World Bank and Korea Development Institute (2004).
2. However, with respect to the environment sector, the recent Armenian MTEF paper contained only one new initiative described on less than half a page and containing a table. This new initiative represented 1.2% of the total environment budget.
3. A pro-cyclical fiscal policy implies that spending goes up (taxes go down) in booms and spending goes down (taxes go up) in recessions.
4. Adapted from IMF, December 2009.
5. In Armenia, there is a separate and independent budgeting process for local governments which has its own strategic planning phase (with four-year strategic plans as part of budget planning) that partially plays the role of mid-term planning for communities.

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## *Chapter 5*

### **Budget planning and management practices in the environmental sector**

*This chapter looks at the major challenges with the design and implementation of multi-year environmental programmes as input to the medium-term expenditure frameworks (MTEF) and the annual budget process. It also looks at donor support for the environment in the region of Eastern Europe, Caucasus and Central Asia and the way it is integrated into multi-year budgeting. Finally, it discusses the capacity of ministries of environment to prepare effective multi-annual programmes for inclusion in the MTEF process and of ministries of finance to guide this process.*

## Medium-term programming and planning in the environmental sector in the EECCA countries

As discussed already, the EECCA countries have introduced a number of important reforms in their budgetary systems, including medium-term expenditure frameworks. Despite the fact that in many of the countries the MTEFs have been made central to these reforms, they seem to be a poor exercise of little practical value. At least this is the picture that emerges of the way the MTEFs are being implemented in the environmental sector in most of the EECCA countries.

One of the main goals of the MTEF is to make the budget process more policy-oriented and link policy, medium-term financial plans and annual budgets in a coherent manner. Where the MTEFs and budgets are organised also around programmes, these programmes are usually based on some national policy and strategic documents. The development of sector strategies and programmes (including agreeing on objectives, outputs and targets as well as the costing of programmes and sub-programmes) is the key **entry point** for the environmental ministries in the MTEF process. The quality of these programmes determines, to a great extent, the resource allocations that will be assigned to the sector (the overall expenditure framework) by the government.

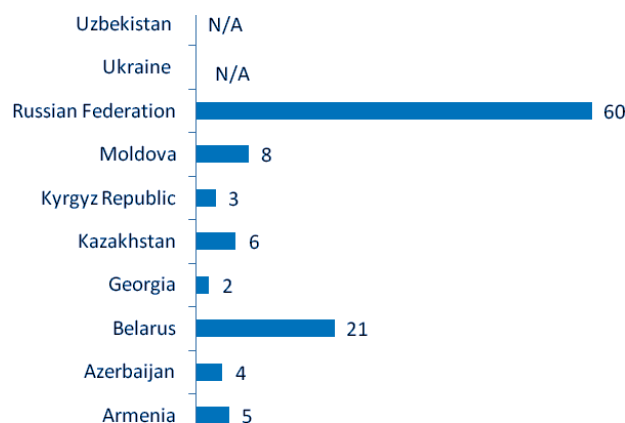
Not surprisingly, all EECCA countries have developed a number of strategic and planning documents that underpin multi-year planning in different sectors. These include, among others, national or regional economic and social development strategies, medium-term socio-economic development forecasts, sectoral strategies, and most recently, poverty reduction strategies which have played a particularly important role in relation to the MTEFs. In addition, EECCA environmental authorities develop their own strategies and concepts where they define the national environmental priorities, the instruments for achieving these priorities and the sources to finance policy implementation. These policy documents often serve as a legal basis for proposing and developing specific multi-year environmental programmes for inclusion in the MTEF/budget process. Unlike other strategic documents, these programmes provide more detail in terms of individual activities and measures, cost estimates, deadlines for implementation and sources of financing. However, the mere existence of such programmes does not guarantee their effective implementation.

In all reviewed countries, in preparing their (mid-term) budgets, sectoral ministries are required to clearly identify their missions, objectives and how these fit into and support the overall government priorities. We asked the countries to quote their three most important environmental priorities. Table 5.1 shows these priorities. Most priorities are quite broadly and even vaguely defined. If priorities are not clear, how are then budget requests formulated and defended? The lack of clear priorities points to the lack of clear vision and unified position of the ministries of environment in the national policy debate.

**Table 5.1. Environmental priorities in the surveyed countries**

Country	First environmental priority	Second environmental priority	Third environmental priority
Armenia	Programmes and measures, provided according to the comprehensive programme of Sevan lake	Preservation of protected areas (national parks, state reserves, etc.)	Other nature-conservation measures
Azerbaijan	Preservation of biodiversity, restoration of natural resources	Measures on combating desertification, mostly on restoration of pastures	Harmonisation of environmental legislation with the EU legislation
Belarus	Protection, rational use, reproduction of natural resources as necessary conditions for providing favourable environment and ecological safety	Reduction of harmful impacts of economic and other activities on the environment by using technologies that meet environmental requirements	
Georgia	Enhancing environmental protection systems	Sustainable use of mineral resources	Enhancing monitoring and forecasting systems
Kazakhstan	Stabilisation and improvement of environmental quality	Creation of appropriate mechanisms for sustainable development	Modernisation and introduction of hydrometeorological and environmental monitoring
Kyrgyz Republic	Protection, rational use, reproduction of natural resources, including forest ecosystems, as an element of good environmental conditions and environmental safety	Special protected areas (state protected areas, national parks)	Other environmental measures
Moldova	Development of policy and management in the field of environmental protection	Improved control of persistent organic pollutants (CO <sub>2</sub> ) and other chemical substances	Environmental safety and environmental quality control
Russian Federation	Creation of conditions for increasing the effective use of natural resources	Ensuring the reproduction of natural resources	Ensuring environmental protection, population
Ukraine	Practical introduction of environmental quality standards, approaching those of the European Union	Dynamic creation of an environmental network of parks and reserves	Development of regulatory basis in order to ensure the effective implementation of the Kyoto Protocol with the aim of motivating enterprises to reduce greenhouse gas emissions as well as attracting additional resources to the budget
Uzbekistan	Ensuring good quality water to the population	Rational use of natural resources	Environmental protection and ensuring environmental safety

In terms of new strategic documents prepared by the ministries of environment over the past five years (2003-08), Figure 5.1 shows that the Russian Federation and Belarus are the most productive countries. In the Russian Federation, the ministry of environment produces, on average, 12 strategic documents per year. It is difficult to judge the impact of so many strategic documents on Russian national environmental policies. In general, however, the proliferation of strategic documents may create challenges both for the ministry's staff to implement and enforce these strategies as well as for those who have to comply with them. At the same time, basically, all countries report that all their strategic documents and objectives are published and made available to the public at large.

**Figure 5.1. Number of new strategies and policy documents prepared by ministries of environment, 2004-08**

*Note:* Uzbekistan and Ukraine did produce strategic and policy documents over the period but the number of these documents was not specified in the survey responses.

In some EECCA countries, however, such strategies have been prepared mainly as a result of the push by donors and the international community where aid-receiving countries hope that the mere production of such documents will bring about much needed external funds. This has been the case in some countries with the preparation of Poverty Reduction Strategy papers (PRSPs) (and the MTEFs, for that matter). Such an approach does not create a sense of ownership and is counter-productive. It can also lead to frustration and cynicism both in EECCA administrations and donors. In addition, a number of international analyses point out to the fact that the link between the PRSPs and the annual budget is not very clear and the PRSPs priorities are not adequately reflected in budgetary allocations.

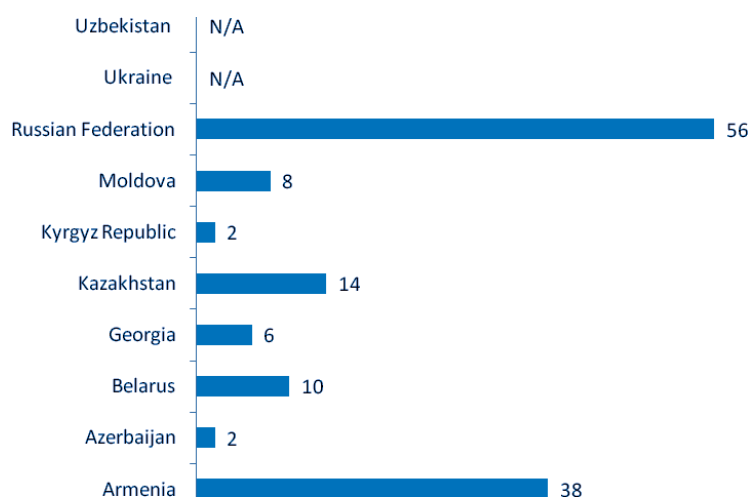
All countries prepare strategic programmes and plans for the environmental sector as well. Due to the cross-sectoral nature of environmental management, these sectoral plans are developed by different ministries and agencies with responsibilities for environmental management. The two most important forms are: (i) feedback on proposed plans/programmes (most likely this reflects the routine and rather formal circulation of documents across ministries); and (ii) stakeholder working groups. The six countries which have stated the stakeholder working groups/workshops as an option are Armenia, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova and the Russian Federation. These seem to largely coincide with the countries where the MTEF process is more advanced. In most of these countries, there are specific sectoral working groups which are charged with the preparation of the sectoral MTEFs.

In most cases, however, these sectoral plans are not supported by dedicated budgets. Strategic plans are mostly prepared to identify strategic priorities but are less significant as a planning financial tool. Sub-sector policies, strategies and programmes are further developed for medium to longer-term periods but are usually not costed and do not include medium-term expenditure scenarios. Where numbers of cost estimates are provided, these are often not realistic and not implemented in practice (see the Ukrainian case study, OECD (2010).

The number of environmental programmes included in the MTEF/budget documentation in the surveyed countries in 2008 is shown in Figure 5.2. The Russian Federation (56 programmes), followed by Armenia (38), come with the highest number of

such programmes. These large numbers do raise concerns about the efforts needed by the staff to implement them as well as about the quality of planning. Most recently, in Armenia, the ministry of finance has tried to address this problem and the number of programmes per government agency has been drastically reduced.

**Figure 5.2. Number of environmental programmes included in the MTEF/annual budget**



The medium-term perspective to budgeting is integrated in the annual budget to various degrees in different EECCA countries. The extent to which the medium-term perspective is reflected in the ministries of environment budget is shown in Table 5.2. Which of these planning approaches is the best is difficult to say, as the answer will depend on the legal basis of the medium-term budgeting in each country and the capacity of the ministry to prepare medium-term budgetary plans. However, it is obvious that very few countries make an attempt to prepare detailed financial plans for the entire period covered by the MTEF.

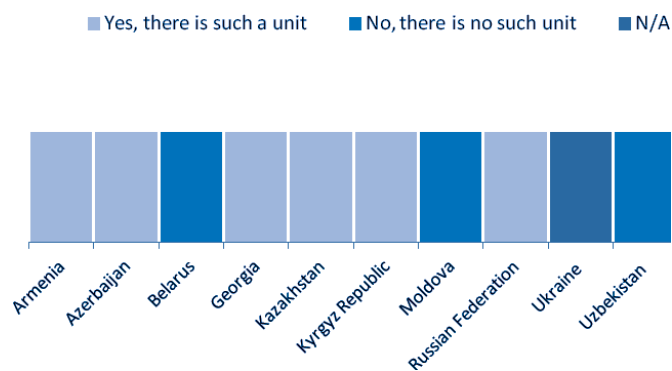
**Table 5.2. Degree to which the MTEF is reflected in the budgets of EECCA ministries of environment**

Level of detail of MTEF reflected in ministry of environment budget	Country
The Ministry of Environment plans its budget in a detailed manner for the whole period covered by the MTEF	Armenia, Kazakhstan, Russian Federation
The Ministry of Environment plans its budget for the MTEF period at an aggregate level only	Azerbaijan, Kyrgyz Republic
The Ministry of Environment plans its budget in a detailed manner for the next budgetary year only and prepares loose plans for the rest of the MTEF period	Georgia, Moldova, Uzbekistan
The Ministry of Environment plans its budget for the next budgetary year only	Belarus, Ukraine (with loose plans for one year ahead)

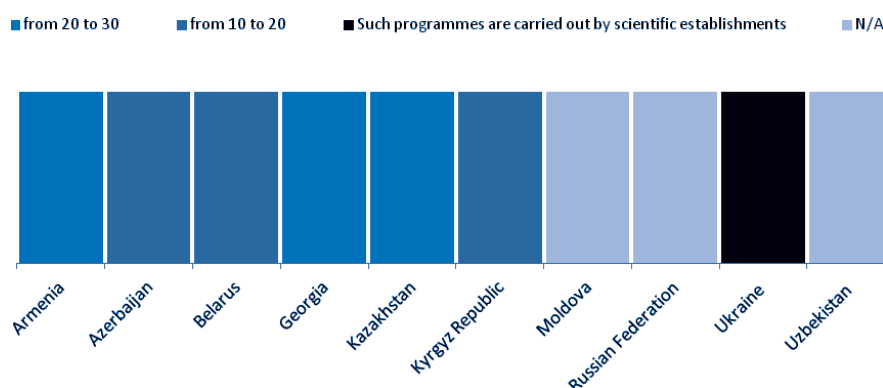
## Design and costing of environmental programmes

Preparing the MTEF documents and related programmes requires dedicated staff. Most countries in the region have created dedicated units to co-ordinate the MTEF/budget documentation process (see Figure 5.3). In Moldova, there is no such special unit, but this activity is co-ordinated by one of the departments in the ministry (Department of analysis, monitoring and policy evaluation). However, from the information that we have, only Armenia and Kazakhstan have dedicated staff in the ministry of environment who work on budget programming and planning issues (six people in Armenia and five in Kazakhstan). In most other cases, it seems that these functions are assigned to regular staff members which they carry out along with their other routine responsibilities.

**Figure 5.3. Is the MTEF process assigned to any specific unit in the Ministry of Environment?**



Moldova and the Russian Federation do not specify how many people are involved in preparing programmes for inclusion in the MTEF/budget process. However, in Armenia, Georgia and Kazakhstan their number varies between 20 and 30, while in Azerbaijan, Belarus and the Kyrgyz Republic, the number of people involved is less than 20 (see Figure 5.4). The lack of staff, and even more importantly, the lack of qualified staff who can prepare realistic and economically sound programmes is often quoted as one of the main reasons for the poor planning process in the EECCA countries.

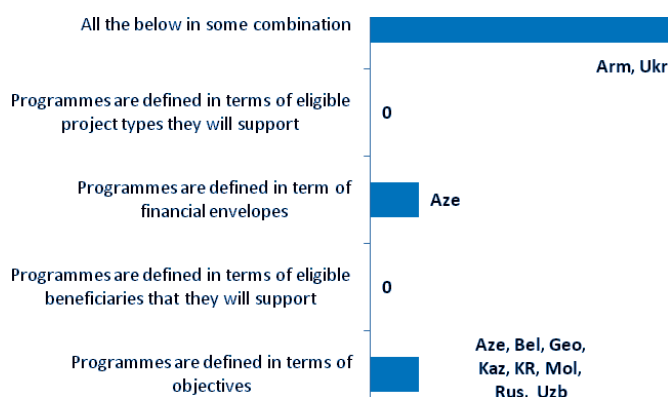
**Figure 5.4. Number of people involved in programme preparation**

In the Ukraine, these functions are assigned to a scientific institute. This is a good option and many OECD countries use the services of such institutes in the preparation of their programmes. It is clear that regular staff in the ministries often would not have either the time or the knowledge to develop and cost such programmes well. Of course, using such external services will require additional resources but these need to be balanced against the costs of implementing poorly designed programmes.

OECD experience shows that well-designed and costed environmental programmes stand a better chance of obtaining the resources requested. If well designed, even when there is a need for budget cuts, such programmes will suffer less damage. If found credible and well-justified, environmental agencies may even receive additional resources for high profile (and particularly new) policy priorities. As OECD country experiences testify, the long-term nature of some environmental (particularly infrastructure investment) policies clearly benefit from the stability created by the medium-term expenditure framework and the government commitments to stick to the financial ceilings allocated to the sector. They also show that with the rise of the environment as a priority on the political agenda, generally, more resources are made available for environmental actions and programmes. At the same time, environmental expenditure in these countries, as any other expenditure, are subject to the discipline imposed by the MTEF process. This means that targets and resource availability are constantly monitored and reviewed.

As can be seen in Figure 5.5, environmental expenditure programmes in most of the surveyed countries are defined mostly in terms of objectives. Only Armenia and Ukraine define programmes in terms different from setting programme objectives, and Azerbaijan sees the financial envelope important enough to include it in the programming process. If even the financial envelope is not consistently considered in this process, it would look somewhat strange when countries state, for example, that they use different costing methodologies in preparing their programmes. This is one example of contradictory statements that we have come across the survey responses, and the reader needs to be aware of this.

**Figure 5.5. How are medium-term expenditure programmes, managed by the Ministry of Environment, defined?**



While all ministries are involved in preparing programmes, Figure 5.5 shows that there is usually little understanding of what this exactly implies. Box 5.1 provides a short description of the main elements that need to be considered when designing a programme and particularly an environmental investment programme. Our experience in the EECCA region shows that many of these elements are often missing in the programmes developed by the EECCA ministries of environment.

#### **Box 5.1. Essential elements of the expenditure (investment) programme**

At a minimum, each public expenditure programme should have:

- Clearly defined objectives and priorities – these objectives should be specific, measurable, realistic and time-bound and priorities should be few and unambiguous.
- Clearly defined timeframe of the programme.
- Specified cost estimates of achieving the objectives.
- Specified sources of financing.
- Specified eligible project types.
- Specified eligible beneficiaries.
- Clearly defined terms of financing, including among others, financial instruments (eligible form of subsidy), co-financing requirements, maximum/minimum level of support.

With regard to the day-to-day management of the programme, it should also have:

- Well-documented principles, rules, and operating procedures for project cycle management.



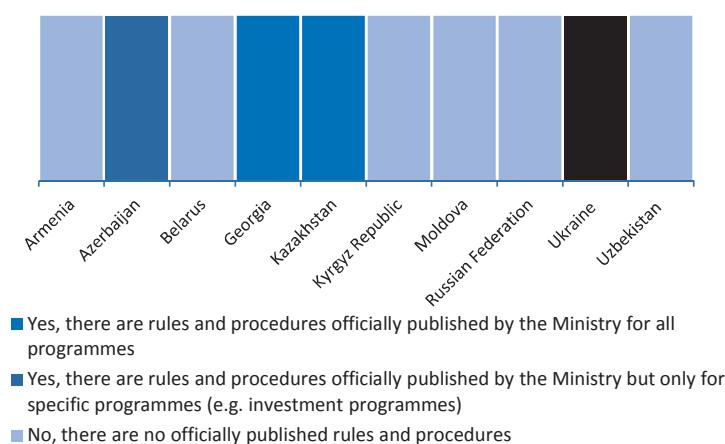
- Clearly-defined and robust criteria for appraisal, selection, and financing of investment projects.
- Clearly-defined procurement rules.
- Selection of the best institutional arrangement to manage the expenditure programme, equipped with sufficient resources to meet its objectives, qualified staff and instruments to implement the programme.
- Performance indicators for the institution managing the expenditure programme.

Source: OECD (2007).

When it comes to investment programmes, prepared and managed by the ministries of environment, most countries reviewed for this survey, except the Kyrgyz Republic and Moldova, report that they do manage such programmes. But only Belarus, Georgia, Kazakhstan and the Russian Federation specify the number of such programmes – one in Belarus, 26 in Georgia, five in Kazakhstan and ten in the Russian Federation. In most cases, there are no dedicated units to manage these programmes, these management functions are spread across ministries' regular staff, or we guess, the staff of environmental funds, where these exist.

At the same time, formal and officially published rules and procedures for the appraisal and selection of the most cost-effective projects do not exist in most countries (see Figure 5.6). This implies certain arbitrariness in the selection of projects for financing. In addition, the cost-effectiveness criterion is not consistently applied in the selection of projects. Even more, the meaning of this criterion is often not well understood and if applied at all, it usually considers the investment costs of projects only.

**Figure 5.6. Availability of rules and procedures for appraising and selecting projects**



This difficulty in the understanding of the programmatic exercise can also be seen in the experience of Ukraine with developing multi-year expenditure programmes. Some of the challenges that Ukraine experiences are common to many other EECCA countries. There are challenges related both to programme design and the actual implementation of programmes. Some of the major challenges are summarised in Box 5.2.

## **Box 5.2. Implementing multi-year environmental programmes in Ukraine**

### **Programme design is inefficient**

There is a general perception in the Ministry of Environmental Protection (MEP) of Ukraine that when new environmental programmes are prepared they often repeat previous programmes. There is little new information and analysis in the new programme of how initial conditions have changed, the same activities are carried out from one year to another. In addition, programmes are overambitious and lack realistic costing. Financial strategies, market studies or feasibility studies are rarely prepared. The programmes lack clear and measurable environmental targets, performance indicators (particularly for the investment part) are not consistent across the years of programme implementation. Eligible beneficiaries and eligible projects are not specified anywhere explicitly. Co-financing requirements are not set either. Only investment data are collected, operation and maintenance costs are not considered. While programmes are consulted with other agencies within the government, there is rarely a broader debate with concerned stakeholders on the need and objectives of the programmes.

### **Project appraisal and selection are weak**

Project appraisal is particularly weak at the MEP. The appraisal and selection criteria are rather basic. No proper appraisal (financial, environmental and cost-effectiveness analysis) and ranking of projects are carried out. Project applications are mostly checked for conformity with current legislation. Evaluated projects are not ranked in any order of importance, hence there are no rules for determining which projects should be financed first with the limited resources.

There is little capacity in the Ministry to verify the information and data provided by project applicants. This prevents the Ministry from evaluating the capacity of project owners to operate and maintain the project in the future and achieve the objectives of the project for which they have obtained support from the ministry. As a result, it is not evident that the most environmental and cost-effective projects are supported by the Ministry. Thus, the MEP misses an opportunity to encourage the development of project preparation capacity in the country. In addition, due to the lack of clear rules, procedures and criteria, the final project selection is altogether highly discretionary and mostly left to the Cabinet of Ministers, which would have even less information on the projects to make well-informed judgements.

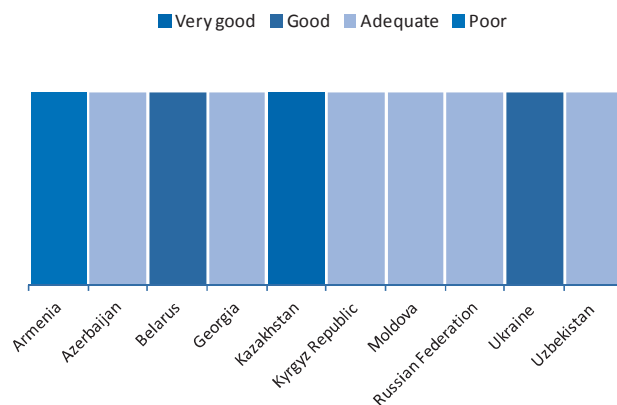
The MEP lacks capacity to effectively monitor and evaluate projects implemented with the Ministry's support. Even worse, the MEP does not collect information on achieved results of the projects it supports. Such information is not available from other institutions involved in programme implementation, either. Therefore, the role of performance indicators identified in the programme is not clear. There does not seem to be demand for such indicators. All this makes monitoring and evaluation of the overall programme implementation extremely difficult.

It is recognised by the authorities that the present processes for investment planning and implementation are complicated and not well co-ordinated with the budget process. Separate planning of capital expenditure and related current expenditure (for maintenance and operations) has led to negative consequences, such as uncompleted construction projects, prolongation of construction terms, and high operating costs of completed projects.

The lack of capacity to co-ordinate and monitor programme implementation coupled with the lack of a clear division of funding responsibilities across various actors participating in a programme often result in further degradation of environmental conditions and health problems for the population. This inertia and lack of action usually lead to even higher future costs for the taxpayer and public purse.

When asked to assess their own capacity to prepare medium- to long-term expenditure programmes, only the Ministry of Environment of Armenia judge their capacity as poor. Belarus and Ukraine assess it as good, Kazakhstan as very good, while Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, the Russian Federation and Uzbekistan believe that it is just adequate. Whether it is so, we leave it to the key players in these countries' governments to judge (see Figure 5.7).

**Figure 5.7. How would you assess the capacity of the Ministry of Environment to prepare multi-year expenditure programmes?**



## Donor aid and aid management

For many years, official development assistance (ODA), and the influence of technical assistance, has been significant in aid-receiving countries, particularly in the environmental sector. Donor-assisted projects have often been “off-budget” and therefore not subject to the same discipline as activities funded through the national budget. Such projects have often had different reporting, contracting and procurement standards, all of which tie up human resources, duplicating a government’s own systems. This is now being addressed through new aid modalities, such as sector and direct budget support.

General budget support is one of the aid instruments seen as a possible fix of some of the above problems. This instrument has been around for a long time but its use intensified during the last decade and particularly after the adoption, in 2005, of the Paris Declaration on Aid Effectiveness which called for better alignment of donor aid with partner countries’ national priorities, harmonisation of donor requirements and an increased use of the financial systems of partner countries in managing aid.

General budget support is defined as a method of financing a partner country’s budget through a transfer of resources from an external financing agency to the national treasury of a partner country. These financial resources form part of the partner country’s global resources, and are consequently used in accordance with its public financial management system. Budget support in this context involves three key elements. First, the transfer of foreign exchange from a donor to the partner country’s central bank takes place. Second, the central bank credits the country’s national treasury with an equivalent amount of local currency. Finally, transfers to the central bank are made only after agreed conditions for payment are met. Once the transfer is made, these resources are used, along with other government resources, in accordance with the partner government’s public financial management systems.

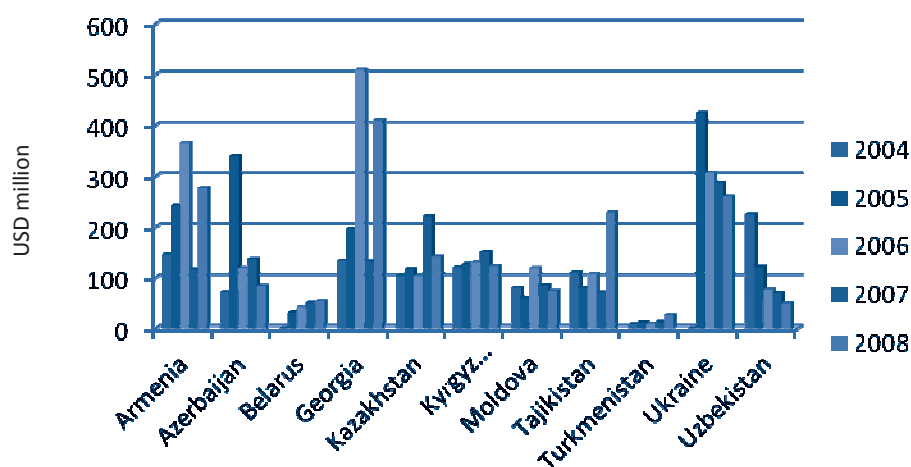
A broad distinction might be made between general budget support and sector budget support. In the case of general budget support, the dialogue between donors and partner governments focuses on overall policy and budget priorities, whereas for sector budget support the focus is on sector-specific concerns.<sup>1</sup> More specifically, there are three main variants of general budget support:

- **Sector Budget Support** – budget support notionally earmarked to a particular sector, sub-sector or programme within the sector.
- **General Budget Support** – budget support that is notionally earmarked for poverty reduction measures as a whole, but not to individual sectors.
- **Full General Budget Support** – this is completely unearmarked.

Data on donor support to the environment sector, provided in the survey responses by the countries, are particularly poor. This may imply the lack of information in the ministries of environment and also ministries of finance as to the level of donor support that goes to the country's environmental sector. Basically only Armenia and Moldova reported data on donor flows for the environment.

To be able to get at least some information on possible donor flows to the EECCA countries, we used the OECD Creditors reporting system database where all OECD members report the level of aid provided to different countries and sectors. Figure 5.8 shows total official development assistance, in terms of commitments, that went to the environmental sector in the EECCA region between 2004 and 2008. This picture shows a generally decreasing trend of donor support to the countries. At the same time, if these numbers are correct, some countries in certain years received significant amounts of support. For example, in 2008, Georgia must have received about USD 400 million as donor support for the environment. It is not clear at what level (national, local) and for what purposes this money was spent. It is not clear either why none of this support was reported in the survey. It should be noted however that while there seem to be some problems with data reporting on donor funds by the EECCA countries, donors themselves are not always very clear about their aid expenditure, either. Information flows from donors on planned and actual flows are usually still rather weak, as our experience in Ukraine has shown.

Figure 5.8. Total environmental official development assistance, commitments, constant 2007, USD million



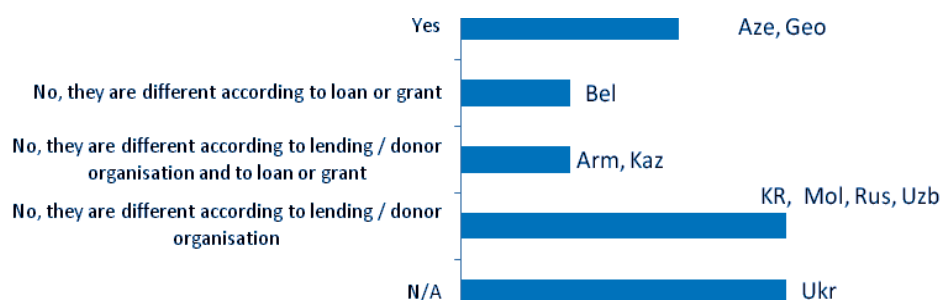
Source: OECD Creditors Reporting System database.

In terms of donor financing, direct budget and/or sectoral support is being more widely used by donors and seems to be replacing project financing. For example, direct budget support provided to Moldova, in 2008, represented about 50% of all donor support and in a period of three years, between 2006 and 2008, it increased more than 6 times. In Armenia, all possible forms of donor support are co-existing, project and programme financing, sector wide and direct budget support. In the period 2006-08, however, direct budget support actually decreased as a share of total donor contributions (from 21.3 to 14.3%). Therefore, it is difficult to make any strict conclusions on the basis of the limited data provided in the survey questionnaire by the countries. However, OECD data show that over the past years donors like France, Germany, the United Kingdom have started using this aid instrument on a regular basis.

On the other hand, carbon financing is gaining place among the environmental funding sources. As a share of total donor financing, carbon financing has also been generally increasing in the recent years. In Armenia, for example, carbon financing (mitigation and adaptation) has significantly increased between 2006 and 2008 – more than two times. It has to be noted though that there will be a lot of competition for resources coming from carbon funds which also makes the case for improved financial planning, if the environment sector would want to get access to this source.

In addition to the lack of clarity on the volumes of donor environmental funds, there are a number of other challenges in managing donor aid. In certain cases, donors' support is still off-budget (*e.g.* Azerbaijan, Belarus, Uzbekistan, Ukraine), in others – audit, control and reporting procedures for regular budget and donor funds are different (see Figure 5.9). In addition, donors support is not always predictable at the time of the annual budget/MTEF preparation process.

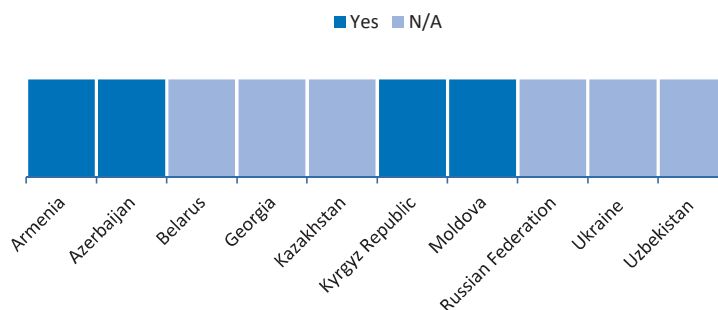
**Figure 5.9. Are audit and control procedures for regular budget and donor funds identical?**



When audit, control and reporting procedures for budget funds and donor funds are different this places a significant burden on the countries' staff in the process of preparing budget execution reports. With the new mechanism of direct budget support, donors have committed themselves to harmonising these control and reporting procedures and using the countries' financial and management systems for this purpose. In Ukraine, for example, cash funding by donors to the Ukrainian government and public sector entities is typically included in the annual budget and reported in budget execution reports. However, technical assistance and in-kind assistance are not. Altogether, however, on the basis of the survey

only, it is difficult to generalise and make any definitive conclusions on how donors stick to these commitments.

**Figure 5.10. Is direct budget support, if provided, predictable?**



It is equally difficult to draw any conclusions on the volatility of donor support and its impact on budget formulation or execution in the EECCA countries in general and in the environmental sector, in particular. However, of the ten countries, only four, Armenia, Azerbaijan, the Kyrgyz Republic and Moldova, report that the exact volume and timing of donor support is known and predictable at the time of the MTEF/budget preparation (see Figure 5.10). The other six countries basically report that this issue does not concern them. This may imply two things, either that these countries have no experience with direct budget support (which is not always the case) or that this information is of no importance for the ministries of finance, in particular, because the amounts are, for example, insignificant. Whatever the reason though, this general lack of information on donor support is somewhat troublesome.

At the same time, this gradual shift to direct budget support poses new challenges to the ministries of environment in the competition for budget resources. To a certain extent, this aid instrument introduces a level-playing field where sectoral ministries and agencies will have to compete for access to donor funds, instead of negotiating them separately on their own. If reporting and predictability of donor funds are more of an issue for the ministries of finance, designing, managing and implementing medium-term programmes and investment projects in line with good international practices are a concern of environmental administrations. Donors who still care that the environmental sector in the EECCA countries does not remain marginalised in this process may choose to require and support improvements in the capacity of ministries of environment staff with managing their expenditure.

### **Institutional capacity needs**

The capacity of the EECCA ministries of environment to plan, prepare, finance and implement multi-year programmes is generally low. More specifically, there is a lack of capacity to gather information and data that underpin the analytical and financial basis of programmes, to conduct economic and financial analysis, to design rules, procedures and criteria for identifying, appraising and selecting cost-effective projects for financing, to monitor and evaluate projects.

This relatively low capacity may be a function of the generally low remuneration of staff of EECCA environmental ministries compared with other, more powerful, ministries in the national administrations. This has resulted in high turn-over of personnel in these ministries. In addition, the relatively low pay results in hiring staff with lower skills; those with strong professional capacities would soon leave the ministry to find better financial offers in the private sector or in other government offices, as this has happened in a number of countries. However, it may also be a result of the lack of demand for good practices for planning and implementing expenditure programmes.

Experience shows that EECCA environmental ministries have little capacity to design programmes in line with international good practices. Investment programmes, in particular, are not well analysed and costed. Financial strategies, market studies or feasibility studies are rarely prepared. While there may be an abundance of programmes, they often lack clear and measurable environmental targets; performance indicators are often simple statements that are rarely verified and rarely used in debates on resource allocations, even within ministries of environment. Investment programmes often lack information on eligible beneficiaries and eligible projects are not specified explicitly. Only investment data are collected, operation and maintenance costs are not considered or estimated.

Generally, the process for investment planning and implementation in many countries are complicated and not well co-ordinated with the budget process. Separate planning of capital expenditure and related current expenditure (for maintenance and operations) has often led to negative consequences, such as uncompleted construction projects, prolongation of construction terms, and high operating costs of completed projects.

Due to the spread of responsibilities for environmental management across a number of levels and agencies in the countries, there is a lack of capacity to properly co-ordinate and monitor programme implementation. This often results in further degradation of environmental conditions and health problems for the population. This inertia and lack of action usually lead to even higher future costs for the taxpayer and public purse.

This general lack of capacity to plan and implement public environmental expenditure over the medium-term as well as the fragmentation of implementation responsibilities, and related accountability, may well be some of the main reasons for the overall low and inadequate funding of environmental programmes and significant budget cuts at times of crisis.

EECCA ministries of finance, but also other key decision makers in the governments, have a special role to play in the financing and evaluating environmental programmes included in the MTEF/annual budget process. With the new “green growth” agenda, the environment can be effectively used to contribute to the growth performance of the countries and not seen only as a cost on the budget. To be effective partners, ministries of finance need to better understand the challenges facing the environmental sector, not giving it a privileged position but rather assessing it realistically. Finance ministries need to provide detailed guidance to environmental administrations on both costing and pricing of environmental products, thus allowing to place a more realistic economic value on different environmental assets and outcomes. They may also require from environmental ministries to justify programmes with solid market studies and sector financing strategies (where appropriate, *e.g.* for large investment programmes). In addition, there is a need for introducing clear rules and procedures for mid-term reviews of the programmes and possible ways for adjusting them.

Given the cross-sectoral nature of the environment, the preparation of robust sectoral strategies and programmes is a serious challenge in the EECCA countries. Significant capacity development in this area is needed among a range of government agencies and levels. There is also a need to work and further support civil society organisations and the private sector in these countries in order to help create popular demand for environmental improvements which can push the environment up the political agenda.

In general, international development organisations play an important role in providing advice and technical assistance in relation to environmental policy. The MTEF process provides a new opportunity for donors to support capacity development in environmental and natural resource administrations in the competition for government resources. To help these administrations to better respond to the challenges posed by the MTEF process, donors could focus their technical assistance on developing particular skills of environmental ministries' staff as well as the preparation of relevant tools. Skills related to valuing the economic costs and benefits of environmental policies and preparing public expenditure reviews for the sector are crucial. Strengthening the information base that supports such analysis is equally important. Support could also be provided for preparing methodologies and guidelines for how environmental programmes should be developed so that they could be integrated into MTEFs and subsequent annual public budgets, and demonstrate their contribution to Poverty Reduction Strategies. These tools however should not be developed without the active involvement of the finance ministries in these countries.

## Major findings

Some of the major findings that emerge from the above analysis are:

- Despite the existence of MTEFs in most of the reviewed countries, the programming process in the environment ministries is generally weak and not sufficiently well understood. This may not necessarily be the case in the environment ministries only but due to the fragmentation of the environmental sector, these programmatic weaknesses are further magnified.
- While many countries have invested significant resources in developing programmes, these programmes are poorly costed. Investment programmes are not supported by detailed market studies or feasibility analyses. Only investment data are calculated, operation and maintenance costs are not considered; as a result, programme cost estimates are not sufficiently robust and credible.
- Programmes often lack clear and measurable environmental targets and performance indicators. Performance information is rarely verified or used in discussions on resource allocations. Therefore, the link of these programme estimates with the annual budget allocations is rather poor.
- Due to the lack of robust criteria, rules and procedures and proper institutional arrangements, the management of investment projects (appraisal, selection and monitoring) is particularly weak in the EECCA ministries of environment. The poor management of public environmental expenditure programmes leads to a further dissipation of public funds and weakens the claim of environmental ministries for maintaining or increasing their budget allocations.
- At the same time, total donor support for the region is generally decreasing. The lack of reliable data on donor support in the ministries of environment and finance



(for that matter) is somewhat troublesome. This lack of data undermines the predictability of donor direct and sectoral budget support. Coupled with the fact that donor support is still off-budget in a number of EECCA countries, this may create additional challenges to annual budget execution in the countries.

- There is some evidence that donors are moving away from project financing to more direct and sectoral budget support (e.g. in Armenia and Moldova). While these new approaches may bring some new opportunities, there is a risk that EECCA environmental administrations may be further marginalised in this process. To minimise this risk, they need to strengthen public environmental expenditure practices in line with good international practices.
- Carbon financing in the region is generally increasing. There is going to be a lot of competition by other sectoral ministries for these resources which calls for further strengthening the capacities of environment ministries in designing and costing multi-year programmes as a way to ensure better access to carbon finance.
- Given the significant capacity needs in the EECCA countries, donors have a role to play in strengthening the sector's knowledge base. This could be done by supporting specific expenditure reviews, market and feasibility studies or the development of methodologies for bringing expenditure planning and management in line with good international practices. Closely involving ministries of finance, at the outset of this work, is crucial.

## Note

1. OECD (2006a).

### Selected sources

- Organisation for Economic Co-operation and Development (OECD) (2007), *Handbook for appraisal of environmental projects financed from public funds*, OECD, Paris.
- OECD (2010), *Medium-term management of green budgets: The case of Ukraine*, OECD, Paris.
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## *Chapter 6*

### **Major findings and recommendations**

*This chapter summarises the major findings and conclusions that have emerged from the survey conducted in the ten countries in Eastern Europe, Caucasus and Central Asia reviewed in the this publication. While designing and implementing a robust medium-term expenditure framework that encompasses the annual budget is a difficult task and requires time and experience, the chapter insists that the rules and procedures embedded in medium-term planning of budget resources provide a window of opportunity to sectoral ministries, including ministries of environment, to improve their financial planning and management procedures, as a basis to compete more successfully for obtaining adequate budget resources for the implementation of their multi-year programmes.*

The assumption, at the start of this work that the countries of Eastern Europe, Caucasus and Central Asia (EECCA) may have rudimentary systems in support to multi-year budget planning turned to be false. The major finding of this survey is that most of these countries adopted MTEFs within a rather short period of time and with a very comprehensive scope. In most cases, the policy and legal pre-conditions for functioning medium-term expenditure frameworks seem to be in place but the knowledge-based system to support their actual and successful implementation lags significantly behind. In other words, the devil is, as usual, in details.

***Progress on enacting reforms of public finance management (PFM) in EECCA is significant...***

On the whole, the national budgets in the EECCA countries have become more comprehensive, based on more realistic macroeconomic assumptions, owing to significant progress in the reforms in the public finance management that these countries put in place. Some of these reforms have been driven by international financing institutions but in some countries (*e.g.* the Russian Federation) they have been a result of a genuine willingness of the government to strengthen fiscal discipline and improve the management of public finances. Progress in consolidating various types of government resources (extra-budgetary funds, public investment programmes, and quasi-fiscal activities) into budget documentation going through legislative scrutiny and in introducing treasury systems and single treasury accounts is also visible. Most of the surveyed countries introduced a full classification of government revenues and expenditure by economic, functional, organisational and funding codes. This facilitates the analysis of social and economic effects of government revenue collection and spending policies (however, these classifications do not facilitate the programmatic approach to budgeting). These reforms were further consolidated in comprehensive Budget Codes, adopted by many of the countries, which also introduced a number of modern budgeting concepts and practices, such as MTEF and performance-oriented budgeting.

Most EECCA countries are in a process of implementing or considering to implement a second generation of public finance reforms, such as medium-term expenditure frameworks, programme and performance-oriented budgets. Seven countries in the region have already introduced MTEFs, in one form or another. These include: Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, and the Russian Federation. The MTEFs in these countries (except in the Russian Federation) are rolling frameworks revised annually. Armenia has the longest experience with preparing MTEFs, as it launched its first one in 1999, and Kazakhstan – the shortest (since 2008). For the first three years of its existence in Armenia, until 2002, the MTEF was prepared by the Ministry of Finance only with support by donors. Sectoral ministries were involved in this process only starting in 2002. At the same time, Belarus is preparing its first medium-term framework which is being launched in 2011 and will cover the period 2011-13. Ukraine and Uzbekistan have not developed MTEFs but have introduced certain MTEF elements in their budgeting practices (two-year programme based budgets in Ukraine and medium-term macroeconomic projections in Uzbekistan). In general, however, most EECCA countries still use in their MTEF and the budget documents the Government Finance Statistics (GFS) budget classification rather than a genuine programme budget classification.

The Russian Federation is a special case with not just a loose expenditure framework: The Russian Federation has gone a step ahead and has introduced three-year budgets, the most recent one adopted by the Russian Duma in December 2010. Strictly speaking, very few of the OECD countries have ever worked with more than annual budgets, as

legislatures are not constitutionally allowed to raise taxes or approve appropriations for a longer period than one year. In this context, it will be interesting to follow the Russian experiment and to learn from it.

In terms of MTEF coverage, five countries report full coverage (Georgia, Kazakhstan, Kyrgyzstan, Moldova, and the Russian Federation) that is, all levels of government and all sectors are included in the MTEF, while Armenia and Azerbaijan report that MTEF applies to central government bodies only. The same five countries report that from the outset the MTEF was introduced as a whole-of-government exercise, implying that ministries of environment were part of this process.

Almost all countries in the region prepare some medium-term macroeconomic and fiscal projections, those who have International Monetary Fund (IMF)-supported programmes seem more likely to keep them regularly updated. To strengthen budget discipline, many countries have started introducing fiscal rules<sup>1</sup> and top-down expenditure ceilings on initial ministries' allocations. Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova report such fixed limitations or hard budget constraints for individual government bodies. These hard budget constraints seem to be working rather well and to have introduced a certain level of stability and predictability in resource allocations. Most countries report that the MTEF/budget process has been increasingly made more policy oriented. Some countries (*e.g.* Armenia, Georgia, Moldova, the Kyrgyz Republic) have put in place institutional arrangements to guide and co-ordinate the process of MTEF preparation (sector working groups).

In addition, six countries (Azerbaijan, Belarus, Kazakhstan, Moldova, the Russian Federation, Ukraine (to a certain extent), have introduced programme budget classification, while Armenia is actively working towards introducing a fully-fledged programmatic MTEF. Obviously, programme as well as performance-based budgeting can be introduced independently from a MTEF process but, in reality, it makes little sense to prepare such a heavy exercise within the limits of one year only. Also, most countries have introduced some kind of performance indicators or targets but these are mostly related to financial information and serve little purpose in the resource allocation negotiations.

### ***...but the adoption of MTEFs has hardly changed the political stance of budgetary processes***

Legislative reforms have been conducted to mandate the use of MTEFs. The main issue is how these reforms are translated into the real (political) life. By and large, it seems that they have been implemented as a condition by donors and International Finance Institutions (IFIs) granting support to the countries. Policy makers and parliamentarians rarely use macro-economic projections or performance information in their debates on policy priorities. The MTEFs are developed but not endorsed by parliaments. Often there are no clear links between the MTEF and the annual budgets. In sum, there is little real demand for these modern budgeting practices on the part of politicians.

On the other hand, preparing a fully-fledged MTEF is a resource consuming exercise and if the government is going to take a formalistic approach to its results, this will bring frustration and cynical attitude in staff and will be just a waste of money. There is some anecdotal evidence that this might be the case in some EECCA administrations. As long as parliaments and ministers do not seriously consider the medium-term costs of the programmes in their policy and budget allocation debates, the MTEF will remain a technocratic exercise of little practical value.

*Meanwhile, the financial sustainability of the environmental sector is further eroding...*

During the three years that preceded the crisis in the EECCA region 2006-08, in absolute terms, domestic public support to the environment sector was generally increasing. Despite the financial crisis that hit the region in 2008, in 2009, in absolute terms, domestic public environmental expenditure increased in comparison to 2008 in six of the countries (Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova and the Russian Federation). As a share of GDP, public environmental expenditure in most of the countries generally decreased in the period 2006-09. The share of the reported public environmentally-related expenditure in GDP varies across the countries, from 0.01% of GDP in Georgia in 2009 to 1.56% of GDP in Uzbekistan, which has the highest public environmental expenditure among the surveyed countries throughout this period. However, these data should be treated with caution, as it is not clear how exactly countries define public environmental expenditure but in most cases data cover expenditure at the national level.

It has to be noted that the public sector should not be the only source of environmental investments in the EECCA countries. The implementation of the Polluter-Pays and User-pays Principles suggests that business and consumers should have an important role in financing environmental expenditure, particularly as public investment declines. Unfortunately, it was not possible to collect data on private sector environmental investments through this survey. It is likely however that generally the private sector is not a major financier of environmental investments in these countries.

In addition, the budgets of the EECCA environmental ministries, although increasing over the years of economic growth, remain negligible in comparison to other “non-economic” sectors, such as health and education. As a share of total government budgets, in 2009, environmental authorities’ budgets range between 0.85% (the highest) in Georgia to 0.11% (the lowest) in Uzbekistan.

This picture may be more nuanced, however, since environmentally-related spending is spread over a large number of sectors. Further analysis, involving sectoral ministries, can shed light on the real picture of environmental expenditure. Together with the transition to the green growth model of development, this exercise can become even more complicated due to the lack of clear “borders” of green growth, on the one hand, and the traditional perception of environmental action as pollution abatement, on the other.

Most of the public resources of the environmental administrations, in 2009, go either to nature protection and conservation (Armenia and Kazakhstan) or water resources protection in Azerbaijan, Belarus, Moldova and the Russian Federation, followed by waste – in the Kyrgyz Republic, Ukraine and Uzbekistan. The countries (except Kazakhstan) spent most of the resources on supporting current expenditure rather than investments. Georgia, for example, made almost no new public environmental investments in the period 2006-09.

In general, access to finance for environmental investments in EECCA is limited. Domestic capital and financial markets are weak and borrowing is expensive, hence the role of the domestic financial sector in environmental investments is negligible in most EECCA countries. Public support, including from extra-budgetary environmental funds (where these exist) and donor aid, remain significant sources of finance for environmental investments in some, though not all, EECCA countries. Carbon finance, for both mitigation and adaptation, is a potentially important source of finance for environmental expenditure that the EECCA countries need to exploit more consistently.

In the post-2012 global climate regime, donors and IFIs will be investing significant resources to support non-Annex I countries (most of the EECCA countries belong to this group). Future carbon finance mechanisms are likely to rely to a great extent on country-based systems for programme and project identification and implementation. Those countries that develop the necessary skills to prepare sound public expenditure programmes and identify cost-effective projects will be more competitive and will stand better chances of benefiting from international support. In order to be successful, such programmes need to be also integrated into the national development strategies and medium-term budgetary processes. In addition, EECCA government administrations need to be willing to apply good practices in public expenditure management, such as accountability, transparency, and efficiency. Therefore, strengthening EECCA administration capacities in this area is key to access international carbon finance.

***...and public environmental expenditure remains extremely opaque and fragmented***

One particular issue that needs special attention is the lack of (reliable) data. If aggregate data are more or less readily available, detailed information on spending by environmental media or types of expenditure are a challenge. Environmental data collection and reporting in line with internationally-recognised standards, such as those of the OECD and Eurostat, are still a weak point in EECCA policy making. A number of countries were not in a position to provide good quality public expenditure data and information and this raises concerns about the quality, sustainability and credibility of the environmental programmes prepared and supported by the environmental administrations. Without such basic data and understanding of what is generally financed at the national and local level, ministries of environment can hardly design programmes which will complement other funding sources. Problems like this become further magnified within the framework of medium-term expenditure planning where well-costed programmes are essential.

***Because of limited capacity, the environmental sector benefits only marginally from PFM reforms***

MTEFs have been introduced as a whole-of-government approach in most of the countries and the ministries of environment have been fully integrated in this process. While most of these ministries have extensive experience with preparing strategies and policies, their programmatic skills seem to be much lower. A lot of ministries' staff are involved in preparing programmes, including for inclusion in the MTEF process, but there is often little understanding of what this exactly implies. All countries have prepared numerous programmes, particularly the so-called targeted environmental programmes, but these are rarely properly costed or supported by specific implementation measures, such as financial strategies, market studies or feasibility analysis. Analytical tools, such as costing or cost-benefit and cost-effectiveness evaluation models, are rarely used in the programming process. Programme estimates are not sufficiently robust, the fiscal impact and economic implications of such programmes are not always clearly identified. Hence the habitually poor link of these estimates with the annual budget allocations.

Programmes often lack clear and measurable environmental targets and benefits, performance indicators (particularly for the investment part) are not consistent across the years of programme implementation. Generally, only investment data are calculated, operation and maintenance costs are not considered. Thus, environmental programmes often have little credibility.

Unfortunately, the reality is that even if other, more powerful, ministries are not particularly better in preparing programmes, because of political priorities, these other ministries are in a position to obtain more adequate level of resources. Therefore, the best way for the EECCA environmental authorities to overcome this obstacle is by developing their capacity to design, cost and defend their programmes on both environmental and economic terms and in line with good international practices. While it should be recognised that the budget process and resource allocation decisions are in large part of political nature, with or without a MTEF, the relatively low capacity of the environment ministries to prepare, cost and implement economically-sound multi-year programmes and finance cost-effective projects may have been one of the reasons for a low budget support for the environment. The absence of sound programming could contribute to a further marginalisation of environmental activities in the governments' agenda. At the same time, preparing a well-designed environment programme, consistent with MTEF requirements, is not a guarantee of increased financing: it is a necessary but not sufficient condition.

***Procedural and organisational problems are likely to limit the finance absorption capacity of the sector***

Several ministries of environment report that they have not been able to spend even the little resources which they obtained from the budget. This may imply some problems with expenditure management practices. Only Armenia and Kazakhstan have dedicated staff responsible for working on MTEF preparation and co-ordination. In the rest of the countries, these functions are fulfilled by regular staff who do this work along with their routine responsibilities.

The management of investment projects is particularly weak in the EECCA countries. In general, there are no robust procedures, rules and criteria to support the investment project cycle. The appraisal and selection criteria are rather basic. Cost-effectiveness is not a prominent criterion in the appraisal of projects so it is not clear if the most cost-effective projects are selected to receive public support. The fact that most countries do not have dedicated staff to manage (appraise, select and monitor) investment programmes and projects on a daily, routine, basis prevents the development of a critical mass of skills in the institution as well as project preparation capacity in the countries, for that matter. EECCA administrations' record with managing and capacity to implement environmental investments is rather poor. This poor management of public environmental expenditure programmes leads to further dissipation of public funds, and weakens the claim of environment ministries for maintaining or increasing their budget allocation. This is particularly crucial when it comes to accessing international carbon funds where environmental ministries are often not the preferred partner. In consequence, there is a need to continue improving the programming, project preparation, and environmental expenditure management practices in the EECCA countries in line with good international standards.

***The shift in donor financing approaches may bring new opportunities, but there is a risk of a further marginalisation of the environmental sector***

In terms of donor financing, direct budget and/or sectoral support<sup>2</sup> is being more widely used by donors and is replacing project financing. For example, direct budget support provided to Moldova in 2008 represented about 50% of all donor support and in a period of three years, between 2006 and 2008, it increased more than 6 times. In Armenia, all possible forms of donor support are co-existing, project and programme financing, sector



wide and direct budget support. In the period 2006-08, however, direct budget support actually decreased as a share of total donor contributions (from 21.3 to 14.3%). Therefore, it is difficult to make any strict conclusions on the basis of the limited data provided in the survey by the countries. It is important to note that data related to donor financing for the environmental sector are also sparse and difficult to obtain. However, OECD database on donor financing shows that over the past years donors like France, Germany, UK have started using this aid instrument on a regular basis.

This shift in donor support practices imposes new challenges to the ministries of environment in the competition for public resources as they need to learn how to work with this new instrument. There is some evidence that countries are having difficulties in dealing, for example, with sector budget support. Experience from Moldova and Ukraine shows that the lack of sound strategies and financial plans for spending donor resources is a serious barrier to accessing donor funds. Unless ministries of environment improve their expenditure management practices, they risk to remain marginalised in this process and lose access to donor resources. Donors, on the other hand, can contribute to good public governance by supporting policy dialogues and actively participating in sector working groups which are responsible for the preparation of sectoral MTEFs.

Carbon financing, along with the budget and extra-budgetary environmental funds, is gaining place among the environmental funding sources. As a share of total donor financing, carbon financing has also been generally increasing in the recent years. In Armenia, for example, carbon financing (mitigation and adaptation) has significantly increased between 2006 and 2008 – more than two times. It has to be noted though that there will be a lot of competition for resources coming from carbon funds which also makes the case for improved financial planning, if the environment sector would want to get access to this source.

### ***Developing technical expertise and promoting further transparency are crucial***

Technical expertise in the preparation of programmes, setting targets and performance indicators and in improved project cycle management can equip ministries of environment with knowledge and skills that would make them more competitive. Donors have a crucial role to play in supporting such methodological and capacity building work in the countries.

The neutrality of the MTEF process with regard to individual sectors introduces a level-playing field that EECCA environmental ministries may be able to benefit from should they aim to change their traditional way of preparing their medium- and long-term programmes and annual budgets. Donors can be instrumental in supporting countries which are willing to improve their public environmental expenditure management practices. A crisis period is often a good time to introduce and strengthen multi-year budgeting. This can help consolidate public budgets and better target policy actions as well as provide healthy public finance for the economy after the crisis is over. The governments and the legislatures need to create further demand for good practices in public expenditure management, including in the environmental sector, should the countries choose to improve their public finance systems and bring them closer to international standards.

### ***Analytical tools for greening MTEFs are needed***

Ministries of environment jointly with the ministries of finance and economy need to prepare a government-wide methodology for assessment of the MTEF process that will cover all environmental programmes prepared by different government agencies. They need to introduce clear rules and procedures for mid-term reviews of the programmes and

possible ways for adjusting them as well as clear lines of responsibility for all actors involved in the implementation of the programmes. This may help overcome the fragmentation in the environment sector.

### *Major recommendations*

The major recommendations that have emerged from this survey address medium-term budgeting, in general, and its application in the environmental sector, in particular. For convenience and clarity, they are split into three groups according to the target audience: recommendations to the EECCA governments, to the ministries of environmental protection, and to donors.

#### *Recommendations to EECCA governments*

- Before adopting full-fledged medium-term budget planning, introduce a medium-term framework to forecast budget revenues and expenditures (a forecasting MTEF), based on state-of-the-art econometric models. Such a framework should clearly and transparently reflect the level of the government's financial commitments.
- Move away from GFS budget classification in the MTEF and annual budget process. The GFS classification is good enough for statistical purposes but not as a basis for a proper programmatic MTEF.
- Develop and endorse a government-wide methodology and harmonise requirements for preparing medium-term environmental programmes in line with international good practices in all parts of the government. Introduce clear rules and procedures for mid-term reviews of the programmes and possible ways for adjusting them by also gradually correcting the programme performance measurement and monitoring framework, based on experience.
- Initiate a series of outreach events to explain to frontline staff in sectoral ministries, and, possibly, the legislature, the concepts of a programmatic MTEF. Such policy dialogues could be used to create further demand for good practices in public expenditure management, including in the environmental sector.
- Involve other relevant stakeholders in policy discussions on the need to improve medium-term budgeting as they can help provide a broad support for such public financial reforms. This can also help improve communication between the government, and particularly the ministries of finance, and other sectoral ministries as well as demonstrate governments' genuine interest in and commitment to this approach to budgeting.

#### *Recommendations to EECCA Ministries of Environment*

- Improve programme design in line with good international practices. This should include, among others, translating a programme's objectives into realistic and measurable environmental targets and performance indicators, setting the optimal level of subsidy support necessary to encourage different actors to undertake environmental measures, introducing rigorous and binding project eligibility, appraisal and selection criteria for financing of investment projects.

- Design data collection and reporting systems, for both public and private entities, in line with good international standard. OECD and Eurostat systems can be used as models in launching reforms in collecting environmental statistical information.
- Make consistent use of financial analytical tools (sector financial strategies, market studies, expenditure reviews, project feasibility studies) when preparing a programme. Base the programme cost estimates on the findings of these tools.
- Ensure the increased transparency of public expenditure by improving reporting and information disclosure requirements as well as by strengthening internal control and external auditing. Improve monitoring of environmental budgetary expenditure against stated programme objectives and targets. Conduct and maintain regular evaluation reviews (every two-three years) of overall progress with programme's implementation.
- Introduce regular monitoring and evaluation of (particularly investment) projects implemented with support from the ministries of environment (in terms of technical, financial, and environmental performance).
- Ensure training and capacity development of environmental ministries' staff with regard to programme design and project cycle management (in developing economic, financial, engineering skills). It is important that ministries of finance be closely involved in such work.
- Develop and maintain a database of all public environmental expenditure programmes, including donor programmes and projects, and regularly prepare performance and financial reports. These should be made public and easy access to this information should be ensured (*e.g.* through ministries' websites).

#### *Recommendations to donors*

- Provide precise and timely information on the amounts and timing of aid that goes to countries. When this is environmentally-related aid, duly inform both the ministry of finance/economy and the ministry of environment. This is particularly important when the aid is not channelled through national level institutions.
- Align priorities with national priorities as well as with country systems (*e.g.* reporting and evaluation processes, procurement rules) that are in use in these countries.
- Support EECCA countries' efforts in building capacities of environmental and natural resource administrations in developing and costing environmental programmes in order to more successfully compete for budgetary resources. Donors can support the preparation of relevant analytical studies and methodologies and the strengthening of data information systems in these countries.

## Notes

1. A multi-annual constraint on a fiscal aggregate (*e.g.* expenditure, revenue, budget balance or debt). It is typically defined in terms of an indicator of overall fiscal performance, such as the deficit/GDP ratio or the debt/GDP ratio.
2. Direct Budget Support (DBS) refers to aid channelled directly to government budgets, to be disbursed using their own allocation, procurement and accounting systems. It is important to note that DBS does not just involve the transfer of funds; the approach has three key elements: technical assistance or capacity building, policy dialogue and the transfer of resources.

## *Annex A*

### **Budget classification systems**

**Line item classification:** Structures expenditure by object according to the categories used for administrative control, for instance: salaries, travel allowances, telephone, and office materials.

**Functional classification:** Structures government activities and expenditures according to their purpose, for instance: policing, defense, education, health, transportation and communication. The United Nations standard functional classification, used in the preparation of national accounts and government Financial Statistics distinguishes 14 major groups, 61 groups and 127 sub-groups.

**Economic classification:** Structures government financial operations according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments; and financing operations. This classification is used in Government Financial Statistics prepared by the International Monetary Fund.

**Administrative classification:** Structures expenditure by the institution responsible for the management of funds. The structure of administrative classification will vary from country to country, as will the number and administrative level of the budget holder.

**Programme classification:** Structures expenditures according to programmes, considered as a set of activities undertaken to meet the same objectives. The programme classification may correspond to a disaggregation of the administrative classification or may cross administrative units.

**Territorial classification:** Structures revenues and expenditure by the geographical area of impact of the financial operation.

*Source:* Based on Schiavo–Campo and Tommasi (1999).



## **Part II**

### **Country fact sheets**

## Armenia

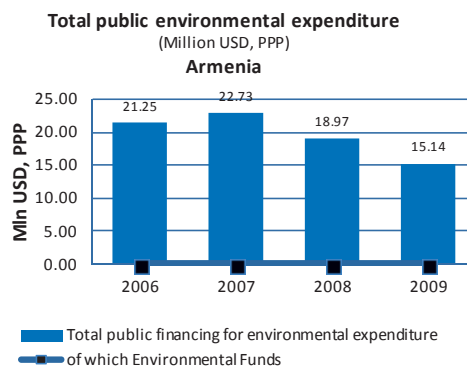
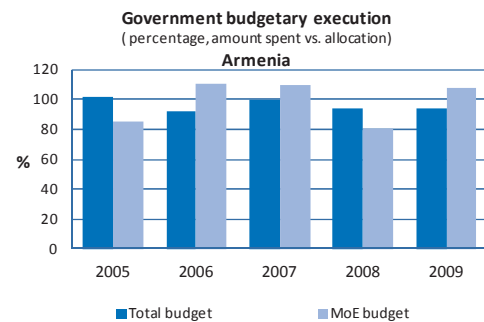
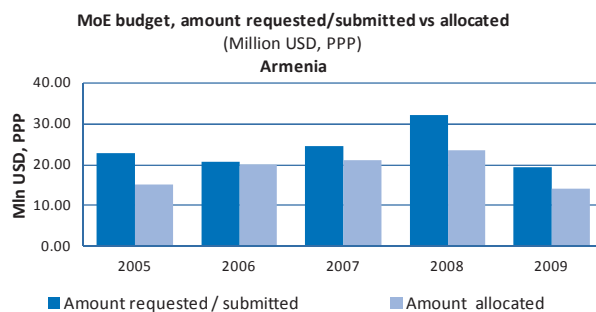
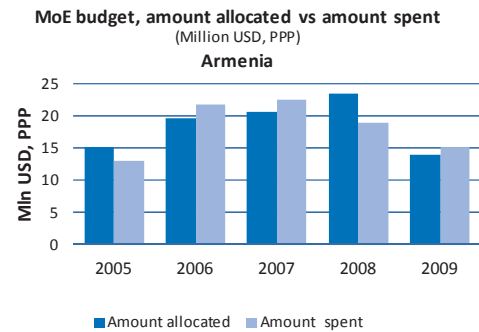
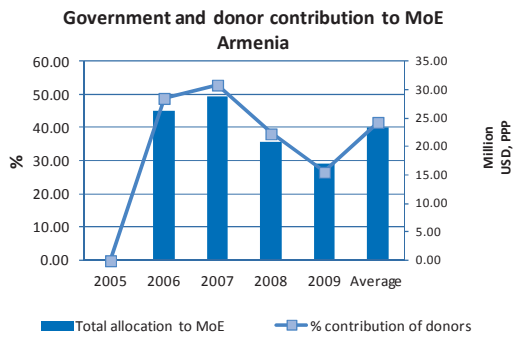
### *1. Major macroeconomic indicators*

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	3.211	3.214	3.218	3.221	3.227	3.234	3.267
GDP, billion USD, current prices	2.807	3.577	4.900	6.384	9.206	11.917	8.714
GDP per capita, USD, current prices	874	1,113	1,523	1,982	2,853	3,685	2,668
GNI per capita, PPP (current international \$)	3170	3590	4210	4940	5750	6310	..
GDP real growth, % change over the previous period	14.0	10.5	13.9	13.2	13.7	6.8	-14.4
General government tax revenue, % of GDP	14.0	14.0	14.3	14.4	16.0	17.0	..
General government expenditure, % of GDP	18.9	17.1	17.6	20.0	22.4	21.7	..
General government balance, % of GDP	-1.1	-1.8	-2.6	-2.8	-2.3	-1.4	-1.5
General government debt, % of GDP	40.9	51.5	39.7	34.3	20.5	20.0	..
Current account balance, billion USD	-0.191	-0.020	-0.051	-0.117	-0.589	-1.372	-1.205
Current account balance, % of GDP	-6.8	-0.5	-1.1	-1.8	-6.4	-11.5	-13.8
Trade balance, USD million	-434.1	-457.9	-588.0	-896.0	1600.0	2649.0	2160.0
External debt (% of GDP)	63.7	52.2	38.0	32.2	23.9	..	..
External debt (% of goods and services)	197.9	189.7	139.1	135.9	123.8	..	..
Domestic credit provided by banking sector, % of GDP	5.6	6.7	8.8	8.1	12.1	16.7	..
Aid, % of GNI	8.8	6.9	3.4	3.3	3.7	2.4	..
FDI net inflows, USD million	121	246	233	450	701	925	700
Inflation, consumer prices, annual average, % change over the previous year	4.7	7.0	0.6	2.9	4.4	9.0	3.4
Gross fixed capital formation, % of GDP	23.0	23.9	29.8	35.5	36.9	40.0	..
Unemployment, total, percent of labour force, end of year	10.1	9.6	7.9	7.2	7.1	6.3	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.



## 2. Country data tables



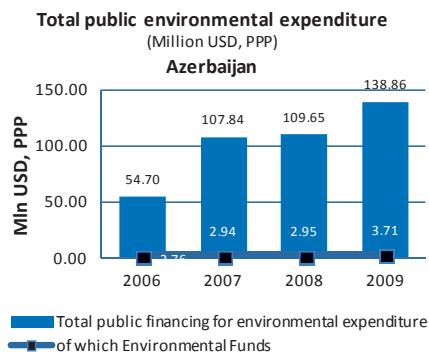
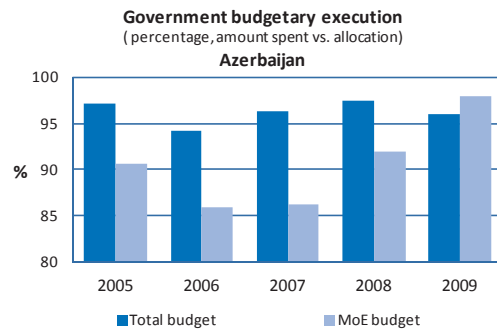
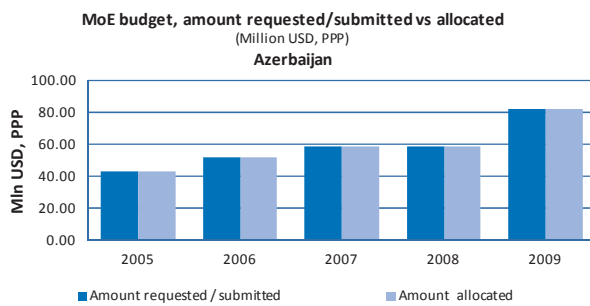
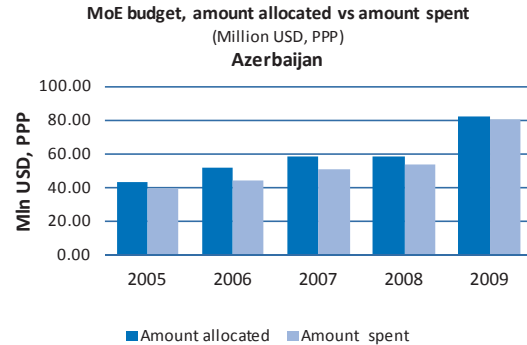
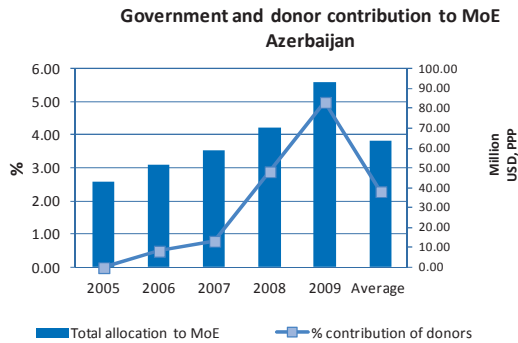
## Azerbaijan

### 1. Major macroeconomic indicators

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	8.423	8.518	8.613	8.707	8.802	8.897	8.968
GDP, billion USD, current prices	7.28	8.68	13.25	21.03	33.09	46.38	43.11
GDP per capita, USD, current prices	874.1	1112.8	1,523.1	1,982.1	2,853.3	3,684.6	2,667.6
GNI per capita, PPP (current international \$)	2910	3200	3940	5380	6630	7770	..
GDP real growth, % change over the previous period	10.5	10.2	26.4	34.5	25.0	10.8	9.3
General government tax revenue, % of GDP						16.74	
General government expenditure, % of GDP	28.5	25.9	22.7	27.4	27.4	27.6	
General government balance, % of GDP	-0.8	1.0	2.6	-0.2	2.4	25.5	9.2
General government debt, % of GDP	20	18.6	14.2	10.8	9.4	9.7	
Current account balance, billion USD	-2.021	-2.589	0.167	3.708	9.019	16.454	10.173
Current account balance, % of GDP	-27.8	-29.8	1.3	17.6	27.3	35.5	23.6
Trade balance, USD million	-98	162	3299	7745	15224	23010	7957
External debt (% of GDP)	37.7	40.2	32.8	23.2	18.6	13.8	..
External debt (% of goods and services)	89.8	82.4	52.2	35.5	26.3	20.2	..
Domestic credit provided by banking sector, % of GDP	9.4	10.9	11.2	13.1	17.2	17.1	..
Aid, % of GNI	4.4	2.2	1.87	1.12	0.81	0.57	..
FDI net inflows, USD million	2,353	2,351	458	-1,301	-5,201	-555	-903
Inflation, consumer prices, annual average, % change over the previous year	2.2	6.7	9.7	8.4	16.6	20.8	1.5
Gross fixed capital formation, % of GDP	52.88	57.71	41.31	29.70	21.40	20.09	..
Unemployment, total, percent of labour force, end of year	..	9.0	8.1	6.8	6.5	4.3	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



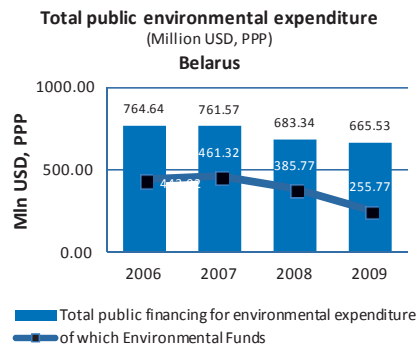
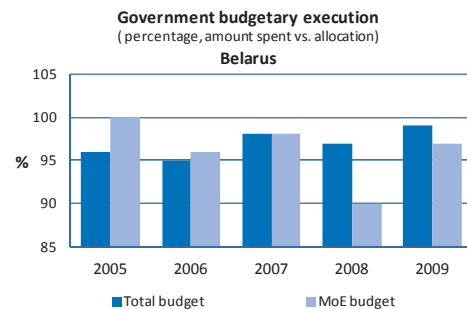
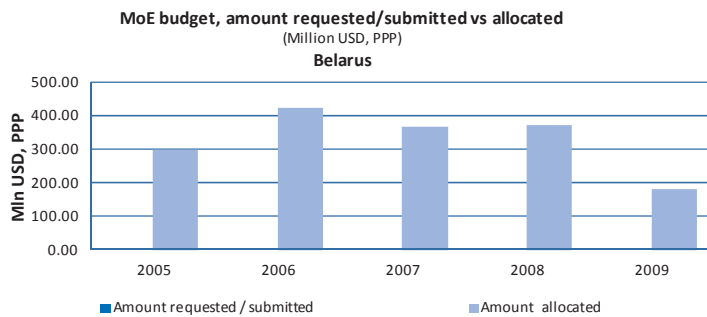
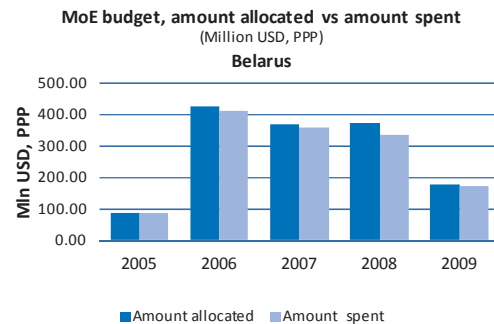
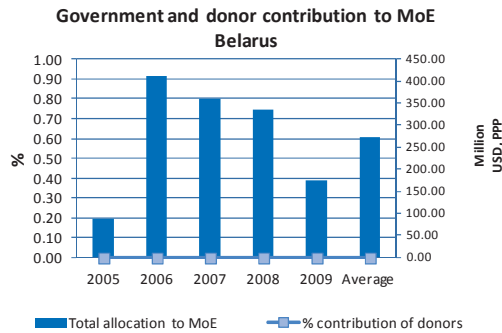
## Belarus

### 1. Major macroeconomic indicators

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	9.849	9.800	9.751	9.714	9.690	9.672	9.480
GDP, billion USD, current prices	17.83	22.72	30.21	36.96	45.28	60.30	48.97
GDP per capita, USD, current prices	1810	2318	3098	3805	4672	6235	5166
GNI per capita, PPP (current international \$)	6540	7530	8540	9710	10800	12120	..
GDP real growth, % change over the previous period	7.0	11.5	9.4	10.0	8.6	10.0	0.2
General government tax revenue, % of GDP	17.7	18.4	20.1	22.2	23.7	25.5	..
General government expenditure, % of GDP	47.7	46.0	48.0	48.0	49.0	49.5	..
General government balance, % of GDP	-1.7	0.0	-0.7	1.4	0.4	1.4	0.4
General government debt, % of GDP	10.4	8.9	8.3	8.8	11.5	13.0	..
Current account balance, billion USD	0.426	1.193	0.435	-1.448	3.032	5.209	6.326
Current account balance, % of GDP	-2.4	-5.2	1.4	-3.9	-6.7	-8.4	-13.1
Trade balance, USD million	1,256	2,272	-638	-2,269	4,071	6,111	6,285
External debt (% of GDP)	23.4	21.3	17.1	18.4	28.1	24.6	..
External debt (% of goods and services)	36.1	31.5	28.4	30.5	46.1	39.7	..
Domestic credit provided by banking sector, % of GDP	22.2	21.2	21.8	27.2	26.9	31.5	..
Aid, % of GNI	0.3	0.2	0.2	0.2	0.2	0.2	..
FDI net inflows, USD million	172	164	305	354	1785	2158	..
Inflation, consumer prices, annual average, % change over the previous year	28.4	18.1	10.3	7.0	8.4	14.8	13.0
Gross fixed capital formation, % of GDP	23.7	25.3	26.5	29.7	31.4	32.7	..
Unemployment, total, percent of labour force, end of year	3.0	1.9	1.5	1.2	1.0	0.8	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



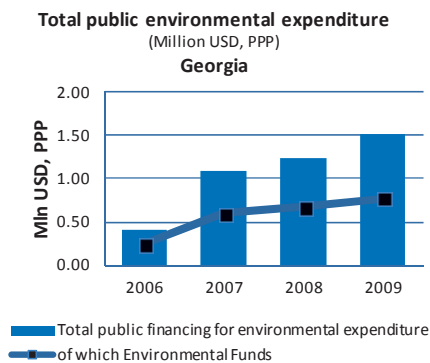
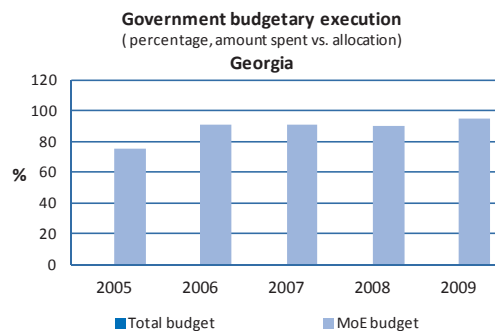
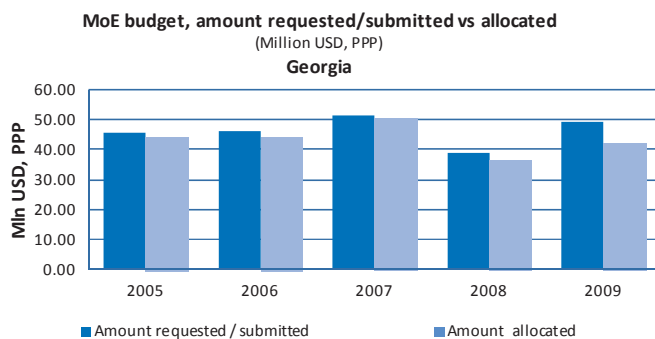
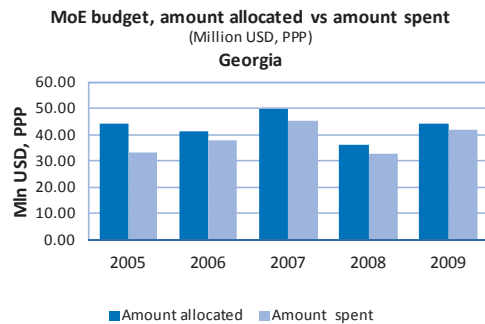
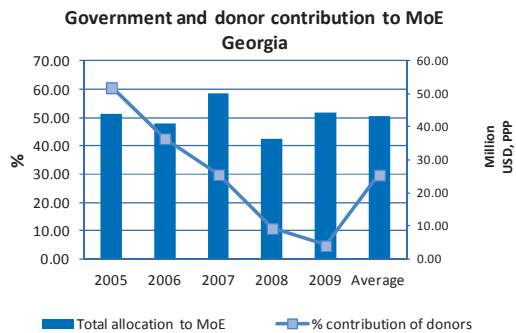
## Georgia

### *1. Major macroeconomic indicators*

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	4.343	4.315	4.322	4.401	4.395	4.382	4.385
GDP, billion USD, current prices	4.0	5.1	6.4	7.8	10.2	12.9	10.7
GDP per capita, USD, current prices	919	1,188	1,484	1,765	2,326	2,937	2,448
GNI per capita, PPP (current international \$)	2,800	3,130	3,560	4,120	4,730	4,920	..
GDP real growth, % change over the previous period	11.10	5.85	9.60	9.38	12.34	2.31	-4.00
General government tax revenue, % of GDP	7.03	9.93	12.11	15.45	17.72	23.82	..
General government expenditure, % of GDP	18.7	19.4	24.9	29.2	33.5	37.1	..
General government balance, % of GDP	-2.5	2.3	-1.5	-3.0	-4.2	-6.4	-9.4
General government debt, % of GDP	61.5	47.0	36.6	28.9	22.9	..	..
Current account balance, billion USD	-0.383	-0.354	-0.710	-1.175	-2.009	-2.915	-1.312
Current account balance, % of GDP	-7.4	-8.3	-9.8	-13.7	-19.7	-22.7	-16.1
Trade balance, USD million	-598	-719	-1,214	-2,019	-2,896	-3,894	-2,670
External debt (% of GDP)	49.0	39.2	33.3	25.7	30.8	35.6	..
External debt (% of goods and services)	151.7	111.4	106.9	77.8	106.0	127.9	..
Gross fixed capital formation, % of GDP	26.67	27.46	28.07	25.56	25.72	22.47	..
Aid, % of GNI	5.7	6.0	4.5	4.5	3.7	7.0	..
FDI net inflows, USD million	335	492	453	1170	1750	1564	..
Inflation, consumer prices, annual average, % change over the previous year	4.8	5.7	8.3	9.2	9.2	10.0	1.7
Domestic credit provided by banking sector, % of GDP	20.2	19.1	21.7	23.9	31.6	32.9	..
Unemployment, total, percent of labour force, end of year	11.5	12.6	13.8	..	13.3	..	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



## Kazakhstan

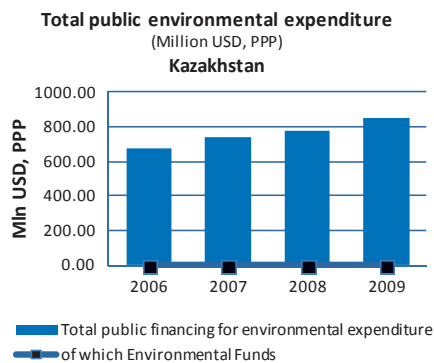
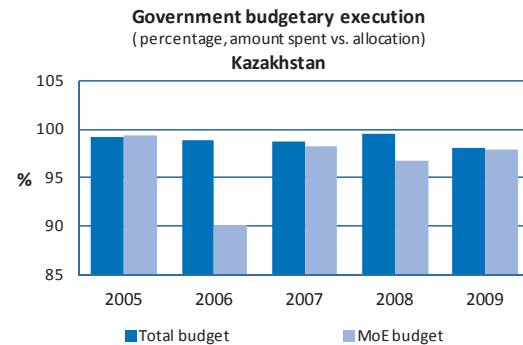
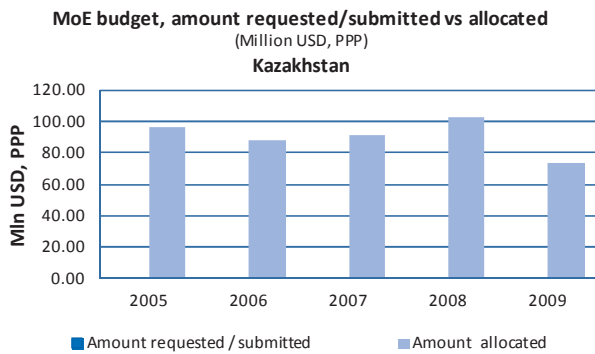
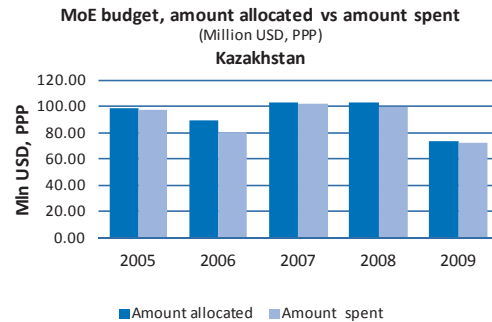
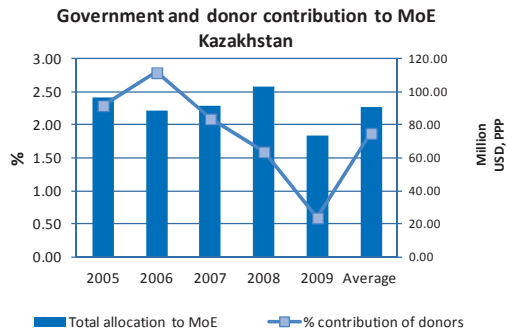
### 1. Major macroeconomic indicators

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	14.95	15.08	15.09	15.40	15.54	15.55	15.57
GDP, billion USD, current prices	30.86	43.15	57.12	81.00	104.85	135.55	109.27
GDP per capita, USD, current prices	2064	2863	3786	5261	6748	8716	7019
GNI per capita, PPP (current international \$)	6530	7230	7830	8690	9520	9720	..
GDP real growth, % change over the previous period	9.30	9.60	9.70	10.70	8.90	3.20	1.17
General government tax revenue, % of GDP	13.08	13.91	17.15	14.85	12.28	12.66	..
General government expenditure, % of GDP	22.33	22.66	22.33	20.24	24.17	26.50	..
General government balance, % of GDP	3.02	2.45	5.76	7.21	4.67	1.06	-2.02
General government debt, % of GDP	14.96	11.39	8.10	6.67	5.84	6.56	..
Current account balance, billion USD	-0.273	0.335	-1.056	-1.999	-8.322	6.279	-3.405
Current account balance, % of GDP	-0.9	1.1	-1.8	-2.3	-7.8	5.1	-3.2
Trade balance, USD million	3679	6785	10371	14700	14142	33500	14200
External debt (% of GDP)	74.34	76.35	76.02	91.47	92.23	78.24	..
External debt (% of goods and services)	153.37	145.76	142.02	178.08	189.97	139.61	..
Gross fixed capital formation, % of GDP	23.04	25.08	27.96	30.20	30.11	31.30	..
Aid, % of GNI	0.96	0.66	0.44	0.24	0.22	0.29	..
FDI net inflows, USD million	2213	5436	2123	6663	8000	10700	8200
Inflation, consumer prices, annual average, % change over the previous year	6.65	7.13	7.90	8.69	10.79	17.14	7.32
Domestic credit provided by banking sector, % of GDP	14.77	21.01	24.74	32.46	40.96	33.51	..
Unemployment, total, percent of labour force, end of year	8.80	8.40	8.11	7.79	7.26	6.64	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.



## 2. Country data tables



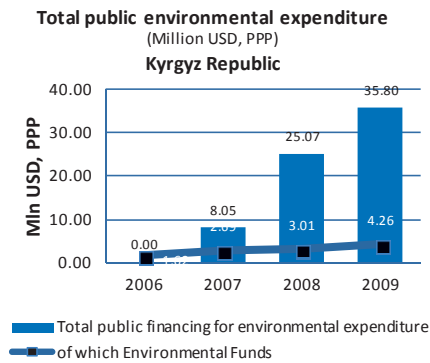
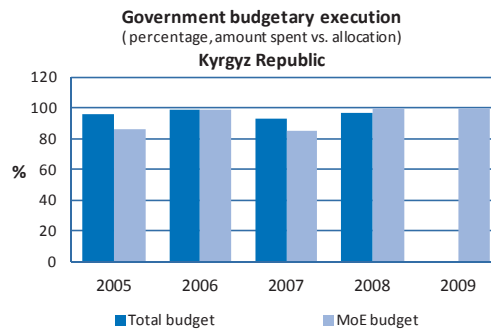
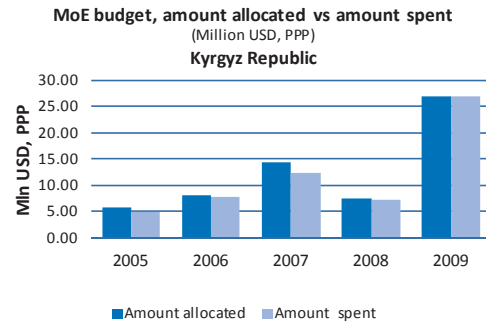
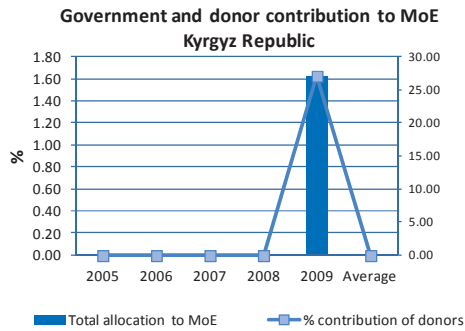
## Kyrgyz Republic

### *1. Major macroeconomic indicators*

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	5.039	5.089	5.140	5.196	5.253	5.311	5.370
GDP, billion USD, current prices	1.92	2.22	2.46	2.84	3.81	5.13	4.57
GDP per capita, USD, current prices	381	435	479	546	725	966	851
GNI per capita, PPP (current international \$)	1500	1610	1670	1790	1980	2150	..
GDP real growth, % change over the previous period	7	7.027	-0.16	3.1	8.5	8.4	2.3
General government tax revenue, % of GDP				14.22	16.40	16.77	..
General government expenditure, % of GDP	27.2	27.7	28.1	28.9	31.0	29.6	..
General government balance, % of GDP	-4.7	-4.4	-3.4	-2.5	-0.3	-0.1	-3.8
General government debt, % of GDP	106.9	92.9	85.9	72.5	56.8	48.6	..
Current account balance, billion USD	0.033	0.109	0.069	-0.087	-0.006	-0.413	0.159
Current account balance, % of GDP	1.7	4.9	2.8	-3.1	-0.2	-8.2	-7.9
Trade balance, USD million	-57	-90	-311	-686	-1,076	-1,612	-1,331
External debt (% of GDP)	103.3	95.2	85.5	77.9	60.3	45.7	..
External debt (% of goods and services)	240.9	205.9	199.7	148.5	102.1	76.1	..
Gross fixed capital formation, % of GDP	13.83	14.76	14.42	23.03	24.62	22.71	..
Aid, % of GNI	10.78	12.39	11.29	11.15	7.43	8.31	..
FDI net inflows, USD million	45.5	131.5	42.6	182.0	208.1	265.2	59.7
Inflation, consumer prices, annual average, % change over the previous year	3.1	4.1	4.3	5.6	10.2	24.5	6.8
Domestic credit provided by banking sector, % of GDP	11.6	8.4	9.4	11.6	14.0	..	..
Unemployment, total, percent of labour force, end of year	9.9	8.5	8.1	8.3	8.2	..	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



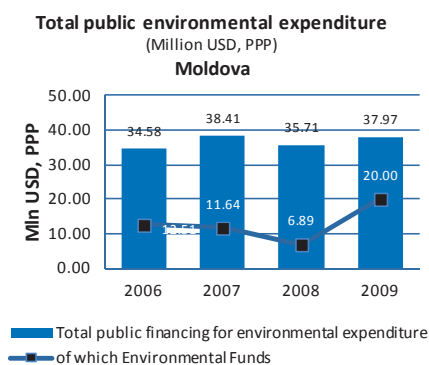
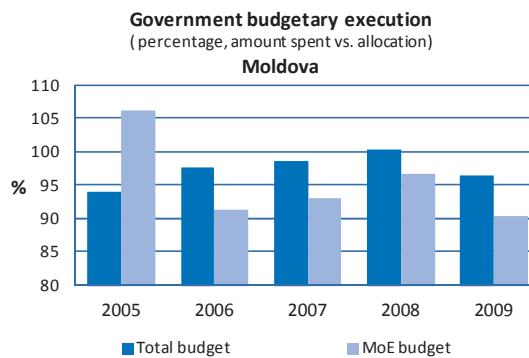
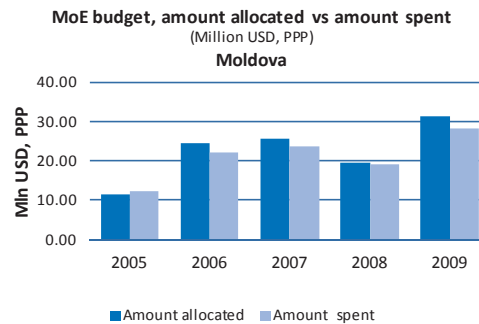
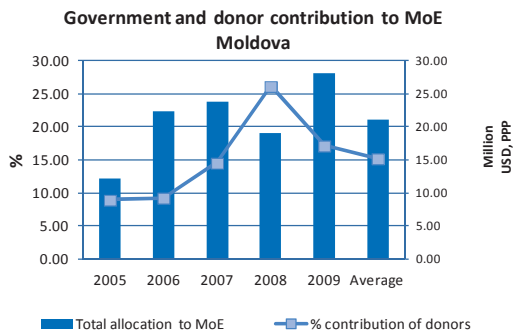
## Moldova

### 1. Major macroeconomic indicators

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	3.618	3.607	3.600	3.590	3.581	3.573	3.568
GDP, billion USD, current prices	1.98	2.60	2.99	3.41	4.40	6.06	5.40
GDP per capita, USD, current prices	547	720	830	949	1229	1695	1514
GNI per capita, PPP (current international \$)	2140	2400	2650	2860	2970	3270	..
GDP real growth, % change over the previous period	6.623	7.363	7.467	4.785	2.998	7.8	-6.49
General government tax revenue, % of GDP	14.67	16.36	18.49	19.57	20.57	20.47	..
General government expenditure, % of GDP	33.1	35.1	37.0	40.1	41.8	41.6	..
General government balance, % of GDP	1.0	0.4	1.5	-0.3	-0.3	-1.0	-6.8
General government debt, % of GDP	58.9	46.0	34.7	34.2	28.5	21.4	..
Current account balance, billion USD	-0.130	-0.046	-0.226	-0.389	-0.674	-0.987	-0.428
Current account balance, % of GDP	-6.6	-2.2	-8.1	-11.7	-15.2	-16.7	-10.7
Trade balance, USD million	-623	-754	-1,192	-1,591	-2,244	-3,223	-1,903
External debt (% of GDP)	97.5	72.5	69.6	74.3	76.3	67.9	..
External debt (% of goods and services)	182.2	141.5	138.0	164.8	167.4	164.6	..
Gross fixed capital formation, % of GDP	18.56	21.19	24.59	28.36	34.10	34.08	..
Aid, % of GNI	5.52	4.04	5.05	6.03	5.54	4.5	..
FDI net inflows, USD million	71	146	199	223	481	679	120
Inflation, consumer prices, annual average, % change over the previous year	11.7	12.4	11.9	12.7	12.4	12.7	0.0
Domestic credit provided by banking sector, % of GDP	29.5	32.0	31.5	34.5	40.2	39.8	..
Unemployment, total, percent of labour force, end of year	8.0	8.2	7.3	7.4	5.1	4.0	..

Source: EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



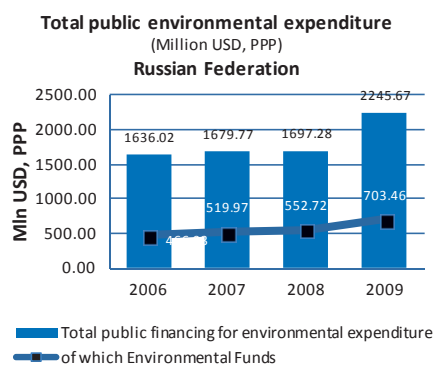
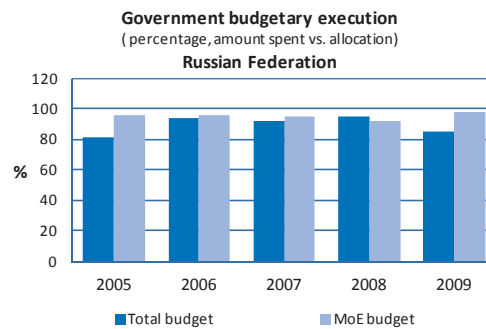
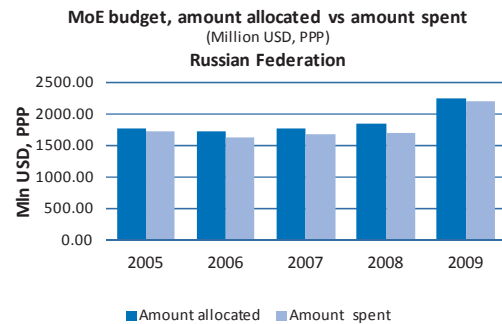
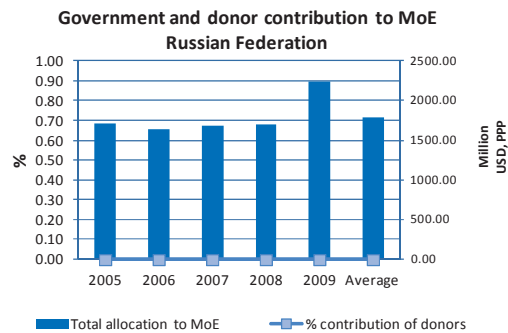
## Russian Federation

### 1. Major macroeconomic indicators

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	145.0	144.2	143.50	142.80	142.20	142.00	141.39
GDP, billion USD, current prices	431	592	764	989	1,294	1,660	1,229
GDP per capita, USD, current prices	2,975	4,105	5,326	6,929	9,100	11,690	8,694
GNI per capita, PPP (current international \$)	9400	10510	11570	12850	14390	15460	..
GDP real growth, % change over the previous period	7.3	7.2	6.4	7.7	8.1	5.6	-7.9
General government tax revenue, % of GDP	13.28	13.22		16.58	16.62	15.67	..
General government expenditure, % of GDP	29.9	27.4	31.5	31.1	34.4	33.6	..
General government balance, % of GDP	1.3	4.5	8.1	8.4	6.0	4.8	-6.2
General government debt, % of GDP	27.0	20.4	13.5	9.0	7.3	6.5	..
Current account balance, billion USD	35.410	59.514	84.443	94.340	77.012	102.400	47.514
Current account balance, % of GDP	8.2	10.1	11.1	9.6	5.9	6.1	4.0
Trade balance, USD million	59,859	85,825	118,364	139,269	130,915	179,742	112,415
External debt (% of GDP)	43.1	36.1	33.6	31.7	36.4	28.8	..
External debt (% of goods and services)	122.2	104.8	95.7	93.6	119.6	92.5	..
Gross fixed capital formation, % of GDP	18.37	18.36	17.74	18.51	21.09	22.03	..
Aid, % of GNI	0.3	0.23					
FDI net inflows, USD million	-1769	1662	118	6550	9158	20425	-7335
Inflation, consumer prices, annual average, % change over the previous year	13.7	10.9	12.7	9.7	9.0	14.1	11.7
Domestic credit provided by banking sector, % of GDP	26.5	24.9	20.6	22.4	25.6	25.9	..
Unemployment, total, percent of labour force, end of year	8.2	7.8	7.2	7.2	6.1	6.2	..

Source: EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



## Ukraine

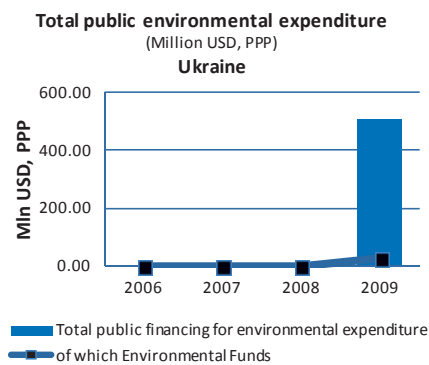
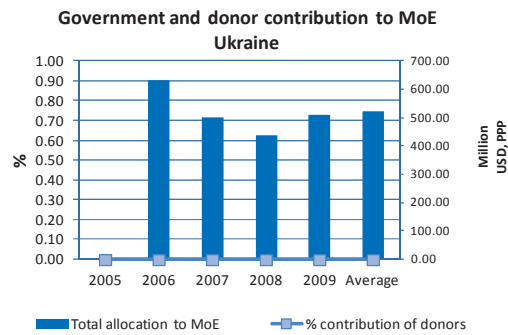
### *1. Major macroeconomic indicators*

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	47.442	47.101	46.749	46.466	46.192	45.936	45.706
GDP, billion USD, current prices	50.13	64.88	86.14	108.00	143.19	180.34	116.19
GDP per capita, USD, current prices	1057	1378	1843	2324	3100	3926	2542
GNI per capita, PPP (current international \$)	4450	5160	5520	6130	6840	7210	..
GDP real growth, % change over the previous period	9.6	12.1	2.7	7.3	7.9	2.1	-15.1
General government tax revenue, % of GDP	13.7	13.3	17.1	17.7	16.5	17.8	..
General government expenditure, % of GDP	37.2	41.5	44.1	45.1	43.8	47.3	..
General government balance, % of GDP	-0.7	-4.4	-2.3	-1.3	-2.0	-3.2	-11.4
General government debt, % of GDP	29.3	25.5	18.7	15.7	12.9	19.9	-
Current account balance, billion USD	2.891	6.909	2.531	-1.617	-5.272	12.763	-1.935
Current account balance, % of GDP	5.8	10.5	2.9	-1.5	-4.1	-7.1	-1.7
Trade balance, USD million	-269	3,741	-1,135	-5,194	10,572	16,934	-3,500
External debt (% of GDP)	47.5	47.3	46.0	50.6	57.6	56.4	..
External debt (% of goods and services)	82.2	77.2	89.3	108.5	128.4	118.7	..
Domestic credit provided by banking sector, % of GDP	33.1	31.7	33.2	45.7	61.1	81.9	..
Aid, % of GNI	0.66	0.57	0.48	0.46	0.3	0.35	..
FDI net inflows, USD million	1424	1715	7808	5604	9891	10913	..
Inflation, consumer prices, annual average, % change over the previous year	5.2	9.0	13.5	9.1	12.8	25.2	15.9
Gross fixed capital formation, % of GDP	20.60	22.55	21.97	24.60	27.08	25.61	..
Unemployment, total, percent of labour force, end of year	9.1	8.6	7.2	6.8	6.4	6.4	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.



## 2. Country data tables



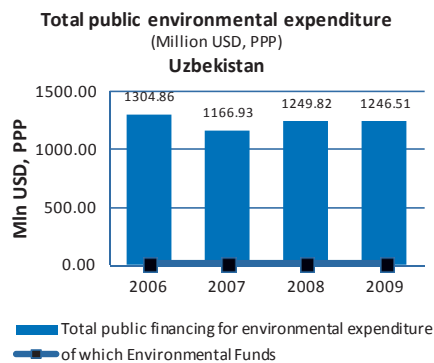
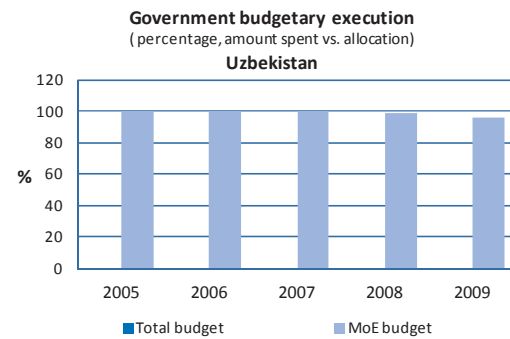
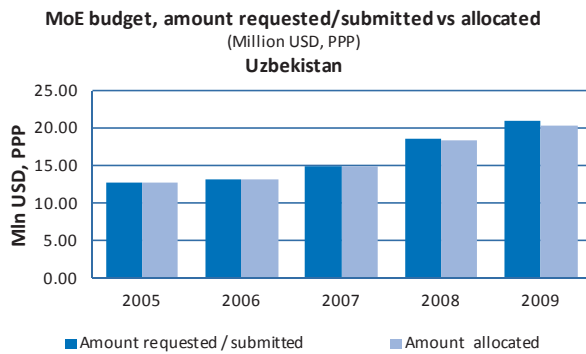
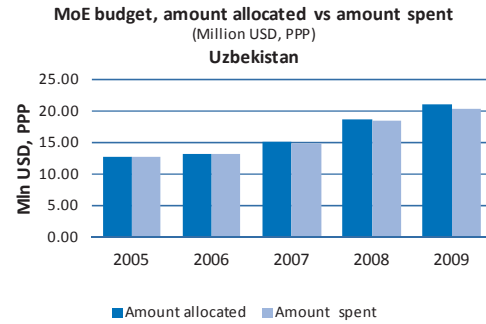
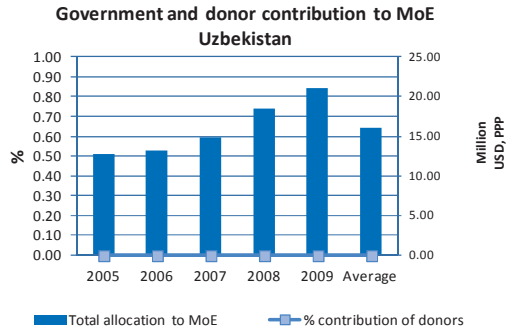
## Uzbekistan

### *1. Major macroeconomic indicators*

	2003	2004	2005	2006	2007	2008	2009
Population, million inhabitants	25.802	26.116	26.408	26.759	27.167	27.553	27.911
GDP, billion USD, current prices	10.1	12.0	14.3	17.0	22.3	28.6	32.8
GDP per capita, USD, current prices	393	460	542	636	821	1038	1176
GNI per capita, PPP (current international \$)	1650	1820	2000	2190	2430	2660	..
GDP real growth, % change over the previous period	4.2	7.7	7.0	7.3	9.5	9.0	8.1
General government tax revenue, % of GDP	..	..	..	..	..	..	..
General government expenditure, % of GDP	33.4	31.6	29.5	29.2	32.7	32.7	..
General government balance, % of GDP	0.1	1.2	2.8	6.8	5.7	10.5	2.0
General government debt, % of GDP	41.6	35.1	28.2	21.3	15.8	13.1	..
Current account balance, billion USD	0.587	0.860	1.097	1.552	1.631	3.562	1.660
Current account balance, % of GDP	5.9	7.0	7.4	9.1	7.3	12.8	7.6
Trade balance, USD million	-269	3,741	-1,135	-5,194	10,572	16,934	-3,500
External debt (% of GDP)	47.5	47.3	46.0	50.6	57.6	56.4	..
External debt (% of goods and services)	82.2	77.2	89.3	108.5	128.4	118.7	..
Domestic credit provided by banking sector, % of GDP	..	..	..	..	..	..	..
Aid, % of GNI	1.94	2.05	1.19	0.87	0.76	0.67	..
FDI net inflows, USD million	83	177	192	174	705	711	711
Inflation, consumer prices, annual average, % change over the previous year	11.6	6.6	10.0	14.2	12.3	12.7	14.1
Gross fixed capital formation, % of GDP	21.55	23.56	21.98	21.48	19.44	23.03	..
Unemployment, total, percent of labour force, end of year	0.3	0.4	0.3	0.3	0.3	0.2	..

*Source:* EBRD, Transition Report 2009; IMF, World Economic Outlook database 2010, World Bank, World Development Indicators database.

## 2. Country data tables



**Table II.A. Uzbekistan, Investments in environmental protection measures and measures on the rational use of natural resources by sources of financing, according to statistical form 18 – KC, as reported by enterprises and organisations**

	Total: Environmental protection and rational use of natural resources			Total: Protection and rational use of water resources			Total: Air protection			Total: Protection and rational use of soil			Total: Protection and rational use of forest resources			Facilities for recycling of industrial waste, excluding waste processing and incineration plants, enterprises and landfills for recycling and elimination of toxic industrial, municipal and other types of waste			Protection and rational use of mineral resources			Protection and reproduction of wildlife and birds										
	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009								
Financed from all funding sources	188.86	120.07	188.01	167.55	10.40	7.05	11.11	2.56	167.83	92.10	143.69	121.31	4.01	1.32	1.80	1.15	0.00	1.18	0.00	0.12	0.00	1.05	1.01	0.70	4.83	15.48	30.40	8.89	0.00	0.00	0.00	32.82
Republican budget	2.54	0.68	2.04	0.22	0.77	0.15	0.00	0.00	0.00	0.00	0.00	0.00	1.77	0.53	1.22	0.00	0.00	0.00	0.00	0.00	0.00	0.83	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Retained earnings of enterprises	185.93	117.74	179.98	160.34	9.64	6.50	11.10	2.56	0.00	91.21	137.74	114.43	1.84	0.44	0.56	1.03	0.00	1.18	0.00	0.12	0.00	1.05	0.18	0.70	4.83	15.48	3.04	0.19	0.00	0.00	0.00	32.82
Other sources of finance	0.39	1.64	5.98	7.00	0.00	0.39	0.02	0.00	167.83	0.89	5.94	6.88	0.39	0.35	0.02	0.12	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	8.68	0.00	0.00	0.00	0.00

*Including, by sources of financing*

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