

FINANCING ENVIRONMENTAL INVESTMENTS

Hoda K. Sabry¹

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SUMMARY

As a national general purpose fund established by Law 4/94, the Environmental Protection Fund (EPF) is an instrument of the National Environmental Policy of Egypt, the latter setting the context within which the Fund seeks to achieve its objectives. The main objective of the EPF is to be a new financial instrument that provides strategic stimuli and financial support for environmental protection initiatives.

This paper aims at increasing the awareness of the role of environmental funds in general, and the Egyptian Environmental Protection Fund (EPF) specifically. It explains the structure of the EPF, its revenue sources, its expenditures, along with its constraints and potentials. The EPF addresses a broad array of beneficiaries: NGOs, private sector, public sector, government entities, and academic institutions in their environmental investments.

OVERVIEW OF THE ROLE OF ENVIRONMENTAL FUNDS

Environmental funds are institutions designed to direct the funds dedicated to the environment to their required uses in the field of environmental protection and development rather than to the government budget, with a negligible portion finally allocated to the environment. Environmental funds use their allocated revenues to provide financial support for various investments and projects that seek to achieve environmental objectives. Environmental funds are found in both developed and developing countries, but vary in nature according to the level of economic development of each country. The funds prevailing in developed countries are specialized funds, while those in the developing countries are general purpose funds.

In a developing economy seeking to reduce the role of the state and working towards achieving market dynamics, increased dependence must take place on private financing of environmental activities, thus, adopting the "polluter pays" principle. The "Polluter Pays" Principle evolved in the European Community countries in the years 1972-1974. It means that the polluter has to bear the financial burden for complying with the regulatory environmental standards. In this case, the cost of compliance will depend mainly on being financed from the establishment's profits, increased equity, or borrowing. The financial support provided by the state, in this case, will be limited to the following exceptions:

¹ Manager of the Environmental Protection Fund, Egyptian Environmental Affairs Agency

1. The case where this support does not negatively affect the country's international trade and level of investment
2. The case where certain economic sectors or industries would face acute problems without receiving support
3. The support will be limited to specific agreed upon periods and directed to solve economic problems with a social dimension that resulted from adopting the environmental policies

This Principle, thus, entails that the polluter will bear all costs of reducing the pollution he is causing to the environment, while the role of the state will be limited to bearing the costs of the public goods and services, such as: protecting nature and bio-diversity, environmental control and monitoring, and research and environmental awareness.

The early stages of transforming into a market economy denote the existence of various difficulties that hinder the efficiency of applying the "Polluter Pays" Principle and developing an efficient system for environmental investments. Some of these difficulties are:

1. Weakness of the environmental policy structure, including the low capacity of implementing environmental requirements
2. Severe financial difficulties of the enterprises, hindering the asset replacement with non-polluting assets
3. Difficulty in changing financial policies to increase the state and municipalities revenues to assist in covering environmental protection costs
4. Non finalization of the privatization process, thus preventing effective management changes in various enterprises
5. Weak involvement of the banking sector in financing environmental projects
6. Immature capital market and instruments that could enable project financing
7. Insufficient accurate information on environmental damages and related social costs

Environmental funds represent a tool that helps resolve such difficulties in economies in transition. In addition to their assistance in providing finance and subsidized finance for environmental investments, they can work with the financial institutions to transfer the required expertise to the private sector.

On the level of environmental policies, environmental funds can direct financing to the more severe environmental problems that affect society and ensure their efficient use. On the other hand, any subsidy to the commercial rate of interest on loans represents an incentive that strengthens the other environmental policies like compliance to environmental standards and other economic measures. Thus, the use of environmental funds in a developing economy is one of the pillars of that economy along with the necessity of the existence of other pillars like a suitable legal structure and a sound executive structure that applies and implements the laws and regulations. General purpose funds represent a bridge for economies in transition to close the gap until maturity and efficient market dynamics in the environmental sector take place. When maturity is achieved, general purpose funds turn into specialized funds in specific environmental issues, e.g. a water pollution treatment fund.

The revenues of environmental funds come usually from environmental fees, fines, and taxes, international and local grants, in addition to the state budget allocation. Examples of environmental fees are entrance fees for nature protectorates, pollution charges on raw materials that produce polluting products, etc. It is essential that a legal foundation is in place to ensure the possibility of establishing fees, in addition to the availability of the adequate administration set-up for the collection of those fees.

Where uses of environmental funds are concerned, various mechanisms are used such as: grants, direct loans, commercial loans interest subsidies, guarantees, direct investment, etc. It should be noted that consideration to the "Polluter Pays" Principle should be given, in addition to the efficient use of the limited resources of the funds through leaning more towards revolving those revenues by using mechanisms whereby funds are paid back, rather than depending mostly on grants.

Based on the above, the most effective and efficient funds have been those that are appropriately designed and operated to meet best practices criteria such as those elaborated in the St. Petersburg guidelines on Environmental Funds in a Transition to a Market Economy (see Box).

If properly implemented, the St. Petersburg guidelines could provide a useful framework for funds to become effective mechanisms. However, evidence from Central and Eastern Europe suggests that "the evolution, effectiveness and potential of the funds is closely linked with the broader progress being made in countries with economic and political reforms, as well as with developments in national environmental policy frameworks."² Funds can, however, play an important role in the transition period by providing good examples and guiding the way for reform in the environmental sectors. It should, however, be noted that it is the Ministries and Governments that set the rules, goals and procedures for the Funds to implement in a cost effective manner – meaning maximizing benefits with the lowest costs.

Box: St. Petersburg Guidelines on Environmental Funds in a Transition to a Market Economy

The St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy (OECD/GD(95)108, Paris 1995), adopted by the EAP Task Force in 1995, recommend the key internationally recognized good standards for institutional set-up, management and performance of environmental funds. The criteria set forth in the St. Petersburg Guidelines have been used as a benchmark in assessing the performance of environmental funds in Central and Eastern Europe.

Main recommendations of the St. Petersburg Guidelines:

- To avoid or minimize the long-term economic inefficiencies inherent in earmarking of funds, expenditure should be targeted to environmental priorities and projects with large environmental benefits relative to their costs.
- Environmental funds should play a catalytic role in financing environmental improvements and support, not compete with, emerging capital markets.
- Environmental funds should reinforce other environmental policy instruments.
- Environmental funds should develop an overall financing strategy, follow clear procedures for selecting projects in order to ensure cost-effective use of resources, adopt effective monitoring and evaluation practices, and make effective use of internal and external expertise to enhance administrative efficiency.
- Environmental funds should leverage increased private sector resources and capital market financing for environmental investments.
- In designing and evaluating fund revenue mechanisms, environmental authorities should ensure environmental effectiveness, economic and administrative efficiency, equity and acceptability.

² Sourcebook on Environmental Funds in Economies in Transition, October 1999, OECD

- Environmental funds should ensure transparency and should be accountable to government, parliaments, and the public for their actions.

Each fund has a management body in the form of a board of directors or a management committee that runs its activities, sets its strategies, makes decisions, and monitors implementation.

Consequently, project financing applies the Competitive Projects Program (CPP) which is implemented by using the project cycle which is comprised of the following activities:

1. Determining the environmental priorities for investments. This is usually based on the National Environmental Action Plan of the country concerned.
2. Translating the priorities into evaluation and selection criteria for the applying projects. The criteria are suitably published in order to allow all interested parties a fair and equitable opportunity for applying for support
3. Evaluating and selecting the projects that will be supported according to the previously set and announced criteria
4. Negotiating the details and conditions of the projects receiving support and completing the various financial and legal agreements, including the disbursement and collection terms and conditions, monitoring and control requirements and completing banks agreements where feasible
5. Determining the support mechanism: grant, direct loans, commercial loans interest subsidies, supplying loans guarantees, loans through financial institutions, or direct investments
6. Monitoring, evaluation, and repayment for each single project, either directly or indirectly through contracted consultants

Environmental funds are supposed to work on enhancing their sources of revenues, of which environmental fees represent an important portion. The existence of an allocated revenues system is directly linked to the necessity of an efficient management process of these revenues, i.e. lowest costs, highest flexibility, minimum administrative complexities. For that purpose, it is important for the environmental funds to possess the flexibility in establishing rules, procedures and mechanisms that allow them to achieve their diversified objectives. From the financial and accounting point of view, adequate systems should be available to deal with the projects and with financial institutions. Additional financial relations could exist in the case of the existence of one or more donor, in addition to a number of beneficiaries, which creates a more complex set-up that needs strong and efficient management systems, monitoring agencies and general public awareness and monitoring.

THE EGYPTIAN ENVIRONMENTAL PROTECTION FUND (EPF)

A major economic incentive established by Law 4/1994, is the Environmental Protection Fund (EPF). EPF is established within the Egyptian Environmental Affairs Agency (EEAA) and has its sources of revenue allocated for it by Law 4/94. EPF is an instrument of the National Environmental Policy of Egypt. The main objective of the EPF is to act as a catalyst to the investments in the environmental field, and act as a major financial tool to enhance and support the major environmental initiatives/models. The revenue sources allocated to the Fund are represented in: state budget allocations, aid and donations, resources of the protectorates fund, fines and compensations for damages to the environment, revenues of EEAA pilot projects, 25% of the proceeds of dues imposed on travel tickets issued in Egypt, costs charged for services rendered by EEAA, fees on licenses issued by EEAA.

Law 4/94 established a broad spectrum of uses that covers almost all environmental activities, being: environmental disasters, pollution prevention, cleaner production, pilot projects in natural resource preservation, transfer of low-cost technology, establishment and management of natural protectorates, funding of research for establishment of environmental programs and the setting of standards and specifications for environmental protection, co-financing of environmental protection projects established by municipalities and NGO's, and supporting the activities and infrastructure and activities.

The EPF follows the best practices that have been developed for Environmental Funds and recognized international standards represented in the St. Petersburg Guidelines on Environmental Funds in Transition to a Market Economy (Ref. page 3). Within the above framework, EPF works according to a competitive projects program and currently uses two financial support mechanisms: grants and commercial loans interest subsidies. Priorities revolve around most of the environmental areas covering the various media: air, water, soil, waste and biodiversity. Activities supported by the EPF vary from pollution abatement to cleaner production and developmental activities.

In order for the EPF to be able to perform its role effectively, it should have the sufficient resources that enable it to provide the financial and technical support for the environmental initiatives nation-wide. This means that EPF has to work on enhancing the existing revenue sources as well as seek new ones. As well, environmental initiatives supported by EPF are models that should be effective in solving the environmental problems, sustainable and replicable.

EPF ORGANIZATIONAL STRUCTURE

While the EEAA Board of Directors has the senior supervisory and strategic role in running the affairs of the EPF, the EPF is managed by a Management Committee of 6 members in addition to its Chairman, the EEAA Chief Executive Officer. Two of the members are senior EEAA officials, the EPF Manager is a member and Committee Secretary, while three members are experts from outside EEAA.

The internal structure of the EPF includes, in addition to its Manager, 5 departments, namely: the Projects Department, the Revenue Management Department, the Accounting Department, the Communications Department, and the Fund Management Committee Secretariat.

EPF REVENUE SOURCES

Law 4/1994 for the Environment endowed the EPF with several revenue sources that provide considerable flexibility and development potential. Revenue sources for the EPF are:

- State budget allocations to consolidate the EPF
- Aid and donations extended by national and foreign organizations for purposes of protecting and developing the environment, as accepted by the EEAA Board of Directors
- Fines and compensations for environmental damages ruled by courts or settled for outside court
- Resources of the Protectorates Fund, as prescribed in Law 102 for 1983 (include: budget allocations, donations and aid to protectorates, user fees, and fines for violating articles of Law 102/1983)

- The share of EEAA from the 25% of the proceeds of dues imposed on travel tickets issued in Egypt (Article 1 of Law 5/1986, and Prime Minister's Decree no. 697/1986, with a minimum of 12.5% of the total proceeds)
- Income of the pilot projects undertaken by the EEAA
- Fees covering charges on services rendered by EEAA to third parties
- Fees on licenses issued by EEAA

Whereby some revenue sources flow in regularly at different levels, like income of pilot projects and fees, other sources like fines and compensations for damages are irregular sources, despite their sometimes sizeable amounts when they occur. Sources like State budget allocation and the proceeds of dues imposed on travel tickets have never actually materialized. The first grant routed to EPF was deposited in 2002 from Danida covering two components of the Egyptian Environmental Sectoral Program funded by Danida. Small amounts of donations are collected through the donation boxes owned by the EPF and installed in major airports in Egypt.

Table 1 lists the EPF revenue for the previous year 2001/2002 according to the respective revenue items.

TABLE 1: EPF REVENUE in LE '000

ITEM	2000/01	2001/02	2002/3
State Budget Allocation	0	0	0
Donations	23	55	1
Fines and Compensations	7764	28778	703
Protectorates Resources	7446	7594	11166
% of Dues on Air Tickets	0	0	0
Return from Pilot Projects	0	242	303
Fees for charges on Services	75	0	0
Fees on Licenses Issued	112	72	65
Interest Earned	2018	919	1054
Other	194	118	143
TOTAL	17632	37778	13435
% of earnings in USD	26%	77%	12%

EPF USES

The legal framework covers all environmental fields as listed in Article 8 of the Executive Regulations of Law 4/1994. The sources of EPF could cover the following uses:

1. Addressing environmental disasters
2. Pilot projects in natural resource preservation and protection of the environment from pollution
3. Transfer of low-cost technology that has proven effective in environmental protection
4. Funding of the production of prototypes of waste management equipment
5. Construction and operation of environmental monitoring stations
6. Establishment and management of natural protectorates
7. Addressing pollution of unknown or non-specific source
8. Funding of research for environmental programs and environmental impact assessments and setting of standards and specifications for environmental protection
9. Co-financing of environmental protection projects undertaken by municipalities and NGOs leveraging community financing
10. Awards for outstanding achievements in the field of environmental protection
11. Pollution prevention projects

12. Support for the EEAA infrastructure and activities
13. Other environmental protection activities approved by EEAA Board of Directors

COMPETITIVE PROJECTS PROGRAM (CPP)

In June 2000, the Fund launched the CPP for providing financial support to both investment and non-investment projects. During the pilot phase, financial support was planned for a total of six projects (6) through two disbursement mechanisms, namely the grants and interest rate subsidy programs. During the pilot phase, the EPF targeted initiatives in the areas of hospital waste, hazardous waste management, solid waste management, and sanitation.

The following 2 years saw developments in the modus operandi of the Fund, making it more efficient in addressing the needs of its various types of beneficiaries.

Since the start of its operations in 2000, the EPF has disbursed an amount of LE 4.0 million in financial support to environmental projects by various types of beneficiaries. Financial support for projects in the pipeline amounts to LE 7.0 to be extended in the form of direct grants to non-profitable projects and interest subsidies to economically viable projects.

THE ENVIRONMENTAL PROTECTION FUND AS AN INNOVATIVE ENVIRONMENTAL FINANCING MECHANISM IN EGYPT

The administrative procedures and project cycle management for the EPF's competitive projects program have been developed to support an effective, efficient and transparent Fund. The resources available at present, however, would not justify the Fund becoming a major player in the environmental sector in the long run. The uncertainty of available resources both from existing sources and the lack of collection from all sources earmarked for the Fund makes long-term planning difficult.

By selecting a limited environmental area to focus on each year the Fund will, given its current resources, be able to provide some support for projects within this one area.

By providing interest rate subsidies to projects through the banking sector, the Fund could ultimately be preparing the banking sector for larger involvement in funding environmental improvements. With a longer-term commitment to this mechanism, the Fund could be initiating a process where banks become more open toward funding environmental projects in general. The EPF is undertaking the process of promoting the EPF in the financial sector signing general cooperation agreements to encourage environmental investments amongst them. Given careful and proper consideration to the further development of the Fund and its possibilities to increase its revenue for the competitive program, the Fund has the potential to become an important player in financing selected environmental priority areas.³

EPF FUTURE PLAN

Throughout the short and medium term, the EPF has ventured on developing its capabilities in order to become an effective financial catalyst for environmental investments.

³ Dan Weuder, U., 2001. The Egyptian Environmental Protection Fund – An Innovating Financing Tool in Egyptian Environment Policy. The Third International Conference & Trade Fair for Environmental Management and Technologies.

A detailed Revenue Enhancement Study has been completed in June 2003, in order to focus on increasing the regular revenues for the Fund. Priority activities regarding increasing specific revenue sources have been designed and procedures put in place to start on implementation. Revenues of EPF are dependent on various players inside and outside the Egyptian Environmental Affairs Agency, and any action plan for enhancing the EPF revenues involves a number of stakeholders.

On the investment side, the EPF is venturing on designing a program for EPF's equity contribution in the capital of joint stock companies working in the environmental sector.

It is in the mid-term plan for EPF to provide financial support in the form of a revolving fund in order to multiply its available funds and target long term sustainability.

The issue of leveraging its own resources by working jointly with other financial mechanisms is an immediate objective for EPF. Currently, the projects financing of the Danida funded Egyptian Environmental Sectoral Program is managed by EPF. Further programs are being designed jointly with technical assistance from Unido in order to achieve stronger financial capabilities. Another project is ready for implementation funded by CIDA in conjunction with the Ministry of State for the Environment and the EPF targeting support to NGOs working in the environmental field. Co-financing a private sector project with KFW has been recently approved and is ready for implementation.

It is hoped that in the coming years, EPF could play a key role in supporting the financial investments in the environmental sector.