UNITED
NATIONS

E

Economic and Social Council

Distr.
GENERAL

E/CN.17/1995/29
20 March 1995

ORIGINAL: ENGLISH

COMMISSION ON SUSTAINABLE DEVELOPMENT
Third session
11-28 April 1995
Item 4 of the provisional agenda*

FINANCIAL RESOURCES AND MECHANISMS

Letter dated 24 February 1995 from the Permanent Representative of Malaysia to the United Nations addressed to the Secretary-General

On behalf of the Permanent Missions of Japan and Malaysia to the United Nations, I have the honour to transmit to you the report of the Second Expert Group Meeting on Financial Issues of Agenda 21 (see annex), which was held in Glen Cove, New York from 15 to 17 February 1995. The meeting was jointly organized and sponsored by the Governments of Japan and Malaysia in collaboration with the United Nations Department for Policy Coordination and Sustainable Development and the United Nations Development Programme.

The objective of the initiative undertaken by the sponsors is to facilitate discussions on finance at the Inter-sessional Ad Hoc Open-ended Working Group on Finance of the Commission on Sustainable Development as well as the third session of the Commission.

I would be grateful if you could make arrangements to circulate the attached report as an official document of the Commission on Sustainable Development under item 4 of the agenda for its third session.

(Signed) RAZALI Ismail
Ambassador
Permanent Representative

* E/CN.17/1995/1.

Annex

REPORT OF THE SECOND EXPERT GROUP MEETING ON FINANCIAL ISSUES OF AGENDA 21

(Harrison Conference Center, Glen Cove, New York,
15-17 February 1995)

OVERVIEW

1. The Second Expert Group Meeting on Financial Issues of Agenda 21, sponsored by the Governments of Japan and Malaysia in collaboration with the United Nations Department for Policy Coordination and Sustainable Development and the United Nations Development Programme took place in the Harrison Conference Center, Glen Cove, New York from 15 to 17 February 1995. The goal of the meeting was to continue discussions on financial issues of Agenda 21 and sustainable development started during the first such meeting (Kuala Lumpur, Malaysia, 2-4 February 1994), and to provide an input to the upcoming deliberations of the Inter-sessional Ad Hoc Open-ended Working Group on Finance of the United Nations Commission on Sustainable Development (6-9 March 1995).

2. The meeting, attended by 50 experts from Governments, international organizations, research institutions and the private sector, was chaired by Dr. Lin See-Yan of Malaysia.

3. The experts' discussion focused on the urgent need to close the resource gap that is preventing full implementation of Agenda 21. Unless prompt and effective action is taken, this gap will continue to widen as the world economy diverges further and further from the sustainable path.

4. This report does not attempt to reflect all the views and suggestions made and does not represent a negotiated text. It reflects, nevertheless, the general thrust of the discussion. Participants agree that it provides a substantive contribution to future discussions in the Commission on Sustainable Development (CSD) and its Inter-sessional Ad Hoc Open-ended Working Group on Finance.

I. INTERNATIONAL FINANCIAL FLOWS

5. The participants discussed the current and prospective situations related to international financial flows and the role of the Bretton Woods and other international development institutions (collectively, the international financial institutions) in the financing of Agenda 21, with particular attention paid to opportunities to link official development assistance (ODA) and financing by international financial institutions (IFIs) with private capital flows.

6. Considering that issues of financial flows are closely interrelated with issues of debt, trade, and macroeconomic policies, the experts suggested that the CSD should promote an integrated discussion of these issues at an appropriate forum.

7. The experts emphasized that national sustainable development strategies, recommended by Agenda 21, provide an important vehicle for bringing about practical collaboration among various organizations and institutions engaged in financing sustainable development at the country level.

A. Private capital

8. Private capital is the largest component of total international financial flows, and its share is likely to continue to rise. It accounts for virtually all of the expansion in resource flows to the developing countries in recent years, though it has been concentrated in middle-income countries.

9. The experts noted that private flows are becoming an increasingly important source of financing for many environment-related infrastructure projects in middle-income countries (e.g., waste-water treatment plants). They suggested that such experiences offer valuable case studies for nations wanting to attract such flows.

10. The experts emphasized that regulatory and other mechanisms must be found to ensure that environmental and social impacts need to be taken into account in investment decisions if private flows are to promote sustainable development.

B. Official development assistance

11. ODA is essential for promoting economic growth and sustainable development in developing countries. In particular, it plays a vital role in financing social and environmental costs, as well as satisfying needs in some areas of the world that have a scarcity of domestic resources and inadequate access to foreign capital. The recent decline in ODA flows is of grave concern.

12. To maximize the beneficial effects of scarce ODA resources, the experts suggested that there is a need to increase its role in leveraging additional external and domestic financial resources, through mechanisms such as joint ventures, co-financing, underwriting of country risks and other approaches. They also stressed the importance of continuing efforts to coordinate and harmonize activities across the bilateral and multilateral system to increase the cost-effectiveness of ODA delivery and use.

13. Donor countries need to take steps to build domestic support for higher levels of ODA, for example by communicating more effectively its role in promoting growth, expanding international markets and addressing global environmental problems.

14. The CSD, in performing its mandate to monitor the implementation of financial commitments contained in Agenda 21, should continue to support efforts aimed at reaching the 0.7 per cent target. The experts emphasized that it is now timely for both donor and recipient countries to explore new approaches to ODA, in the CSD context, that increase its effectiveness and thus make more rapid progress towards meeting the accepted United Nations target of 0.7 per cent of GNP.

C. International financial institutions

15. Despite the growing importance of private capital flows, IFIs continue to have a crucial role in financing sustainable development.

16. To ensure coordination of sustainable development efforts at the country level, the experts emphasized that IFIs should seek closer cooperation with national sustainable development councils, which bring together representatives of relevant government agencies and non-governmental constituencies.

17. Furthermore, they stressed that the CSD and the governing bodies of IFIs should strengthen communication and partnership to further international dialogue and action on sustainable development.

18. The experts emphasized that there is now an urgent need for the CSD to invite the governing bodies of IFIs, in particular the Interim and Development Committees, to consider increasing their current activities and financing and ensure that all of them are in support of sustainable development. Specifically, the CSD should encourage IFIs to extend further their efforts beyond incorporating environmental and social components into their projects and activities, by integrating the economic, social and environmental goals of sustainability in their overall financial policies, strategy formulation and priority-setting. A similar approach should apply to the Global Environment Facility (GEF). Furthermore, IDA is a crucial mechanism to support sustainable development of the low-income countries and should be adequately replenished.

II. INNOVATIVE INTERNATIONAL MECHANISMS

19. The discussions focused on the feasibility of applying a global environmental user charge (such as an air transport) and market-based mechanisms (such as tradeable CO_2 permits and joint implementation), bearing in mind that detailed discussion on them had already taken place at the recent Prague Workshop (12-14 January 1995) on the use of economic instruments as effective mechanisms and tools for sustainable development.

A. Environmental user charge on air transport

20. Air transport of passengers and cargo is a key source of environmentally damaging pollution emissions. The experts recognized that a properly designed environmental user charge on this activity, as just one of several possible international environmental user charges, would discourage global environmental damage and would raise funds for environmental protection and remediation activities.

21. The design of such a charge would need to be carefully considered. Ideally, it should be assessed on the quantity of pollution emissions. A second-best but more easily administered option would be to assess fuel consumption. In any event, the charge should not be assessed on either passenger miles or airline revenue.

22. It is important to specify how the charge would be collected and how the renevue it would generate would be distributed and used. One possibility would be to collect it in the countries where air travel originates and to share the revenue between the collecting country and a multilateral fund dedicated to international environmental problems.

23. The experts suggested that the CSD should encourage further study of environmental, economic, legal, administrative and political aspects of this mechanism, with a view to determining its practical feasibility.

B. Internationally tradeable CO_2 permits

24. Internationally tradeable CO_2 permits are a promising mechanism for bringing about cost-effective reductions in emissions of this greenhouse gas and transferring new and additional financial resources to developing countries and countries in transition. The experts noted that experience with existing SO_2 markets in the United States of America is encouraging and should be examined for lessons that could be applied to CO_2 in an international context.

25. The experts suggested that the CSD should encourage further study of such a proposal with a view to the development of a pilot scheme at an appropriate time, to gain experience and provide a framework for further research and development. Such a scheme should involve both industrial and developing countries on a voluntary basis in order to create opportunities for gains from trade and to ensure that developing countries can benefit from these opportunities from the outset.

26. The experts stressed that it would be helpful if Governments could encourage and facilitate the participation in such a scheme by emitters of CO_2, in particular utilities and heavy industries. The experts suggested that schemes could be designed to assist Governments participating in the United Nations Framework Convention on Climate Change to develop and implement effective mechanisms for dealing with climate change.

27. Experience with other traded goods suggests that commodity exchanges and other forms of market infrastructure would play an important role in developing markets for CO_2 permits. The experts suggested that the CSD should encourage the active involvement of such parties in a pilot scheme for CO_2 permits.

C. Joint implementation

28. The expert group considered that joint implementation could provide a bilateral mechanism for developed countries to compensate developing countries and economies in transition for carbon sequestration services or other net reductions in carbon emissions, through transfers of financial resources and/or technology.

29. To ensure that developing countries and economies in transition receive their fair share of the cost savings that utilities and other partners derive from joint implementation activities, the experts suggested that the CSD should encourage Governments to explore such possibilities as: (i) the establishment

of a clearing-house for collecting and disseminating financial and other information on existing and proposed joint implementation activities; (ii) the development of auction systems to increase competition for access to developing countries' carbon services; and (iii) a levy (in effect, a windfall profits tax) on the estimated cost savings by the partner paying the compensation.

III. MOBILIZATION OF DOMESTIC RESOURCES

30. The discussions focused on environmental user charges, environmentally damaging input subsidies and a multilateral consultative process for encouraging domestic policy changes to mobilize domestic financial resources.

A. Environmental user charges and environmentally damaging input subsidies

31. Although external resources are essential, the bulk of resources for the implementation of Agenda 21 must ultimately come from domestic sources. Effluent and emissions charges and other environmental user charges based on the "polluter pays" principle not only mobilize resources, but they also induce consumers and producers to change their behaviour towards more sustainable norms.

32. The experts stressed that for environmental user charges to provide effective incentives to reduce pollution, they should be assessed, in so far as possible, on the amount of pollution discharged, not on industrial output or revenue.

33. The introduction of environmental user charges and related means of "greening" the tax system could provide macroeconomic benefits (a "double dividend") by shifting the tax base away from economically valued activities, such as employment and income, and towards economically damaging activities like pollution.

34. The expert group emphasized that the reduction of environmentally damaging input subsidies (including indirect subsidies represented by unduly low user fees for natural resources) is also an attractive means of mobilizing domestic financial resources, for reasons identical to those for environmental user charges. Global estimates of such subsidies indicate that they are comparable in magnitude on an annual basis to the total domestic resource needs for Agenda 21.

35. The experts suggested that the CSD should promote studies on the environmental, social and economic impacts of these policy measures at current levels and at alternative levels consistent with sustainable development. It should also promote interministerial consultations in national and international forums to discuss the findings and policy implications of these studies.

36. Even in advance of the studies, the CSD should encourage Governments to consider reducing environmentally damaging subsides and to utilize the potential savings to meet financing requirements for sustainable development.

B. Multilateral consultations on domestic policy changes

37. The experts noted that the concerns about international competitiveness, distributional impacts and other factors frequently hinder unilateral action to reduce environmentally damaging input subsidies and to implement environmental user charges. Multilateral consultations offer a possible means of helping overcome these barriers.

38. They emphasized that such consultations should be flexible and proceed in stages, and they should address selectively sectors and policies that offer particularly promising opportunities for environmental, social and economic gains. Moreover, they should be demand-driven and voluntary, with country involvement being determined by interest in the specific matters under discussion. They could be organized on a subregional, regional or global level, as appropriate.

39. The experts stressed that these consultations should respect the right of countries to set the level of environmental standards. They should also allow countries at differing stages of development to proceed at different speeds in implementing agreed-upon policy changes.

40. The expert group suggested that the CSD, supported by other organizations and financial institutions, should provide leadership in advancing such a process by developing a concrete proposal for further consideration. In this context, the CSD’s growing efforts to encourage the voluntary presentation and examination of national experiences in developing and applying national sustainable development strategies can contribute importantly to the identification of, and agreement on, shared national goals that could form the basis for eventually implementing such a process.

IV. A MATRIX APPROACH TO SECTORAL AND CROSS-SECTORAL FINANCE

41. The expert group reiterated that the use of economic instruments and market-based policy reforms on a wide-ranging scale offer the possibility of substantially reducing the financing gap of meeting the goals of Agenda 21 and of complementing the additional financial resources required to achieve sustainable development. Initial estimates indicate that national measures alone could reduce the total funding needs significantly, and national and international measures combined could do so by an even greater amount. Further research is needed to determine this potential in more detail.

42. The discussions focused on the specific economic and financial instruments described in the previous section. There is, however, a wide range of instruments available for meeting the financing needs of the individual sectors and cross-sectoral provisions identified in Agenda 21. There is also a wide range of policy reforms that could make these instruments more effective. Reforms remove the root causes of unsustainable development, thus ensuring that additional financial resources flow into investments that move national economies towards more sustainable paths.

43. Given the broad scope of Agenda 21 and the wide range of economic and financial instruments and policy reforms relevant to it, the experts emphasized

that there is need for a transparent conceptual framework for structuring discussions on financial aspects of the Agenda. The table (see annex) attempts to present such a framework in matrix form. 1/

44. In the context of the formulation and development of national sustainable development strategies, the group suggested that the CSD should, including through inter-sessional activities, support efforts to quantify the effectiveness and promote the use of these instruments in mobilizing resources and creating incentives for more sustainable consumption and production. These can build on case-studies of existing applications to facilitate exchanges of experience among countries.

45. The experts indicated that the focus of inter-sessional activities should be to highlight the most promising options for particular countries or regions. These options are generally ones that offer both environment and social benefits and tangible economic returns ("win-win" options). The group suggested that the CSD may wish to encourage countries or groups of countries to launch pilot programmes to experiment with these options.

46. Finally, the experts recommended that the CSD should support efforts to consider additional policy-relevant dimensions of the matrix, including: (i) the public and private parties involved in decisions on and implementation of the options; and (ii) the impacts of each option on particular social groups. This process should involve consultations with all the stakeholders concerned.

Notes

1/ The matrix presents, in compact and interrelated form, all Agenda 21 issues (each row represents an individual sector or cross-sectoral issue) and the principal financial instruments and policy reforms potentially applicable to each (each column represents a particular instrument or reform). By looking across any row, one can see that there are several financing options for individual sectors and cross-sectoral activities. These options are often complementary. By looking down any column, one can see that individual financing options are typically applicable to more than one sector. The matrix is filled in detail only for those issues which are on the CSD's agenda in 1995. Often, an option that is implemented in one sector has positive spill-over effects in other sectors.

Annex

MATRIX OF FINANCIAL INSTRUMENTS AND POLICY OPTIONS

	External resources		International policy environment		
Sector	ODA	GEF	Debt relief	Trade flows	Private financial flows
Sustainable development	X		Rescheduling Debt for sustainable development swaps	X	BOT
Biodiversity		X	Debt-for-nature swaps	Biodiversity Patent rights	Green funds Venture capital
Forest resources	X	X	Debt-for-nature swaps	Terms of trade	Green funds
Fragile ecosystems	X	X	Debt swaps	Non-resource-based employment	Green funds
Fresh water resources	X	X		More efficient water use	Foreign direct investment
Land resources	X		Debt-for-equity swaps		
Sustainable agriculture	X		Debt-for-sustainable-agriculture swaps	Market access Terms of trade	Foreign direct investment
Atmosphere		X	Debt relief for energy efficiency improvements	More efficient energy use	Foreign direct investment in the energy sector
Oceans		X			
Hazardous waste					
Toxic chemicals					
Solid waste					
Radioactive effects					
Health	X				
Urban environment	X				
Biotechnology				Market access Profit sharing Technology transfers	Venture capital

X: Important and self-explanatory contribution.

Sector	National policy reforms					
	Economic and financial reforms	Property rights	Resource pricing	Subsidy reduction	Taxation	Environmental charges
Sustainable development	Competitive capital markets	Secure property rights	Full-cost pricing	Reduce energy and capital subsidies	Green taxes	Depletion of pollution charges
Biodiversity	Environment funds	Biodiversity patents	Prospecting fees	Reduce land conversion subsidies	Habitat protection subsidy	Deforestation charge
Forest resources	Environment funds	Long-term concessions Bidding	Forest product pricing	Below cost timber sales Conversion subsidies	Forest concession taxes	Deforestation charge
Fragile ecosystems	Environment funds	Communal property rights		X	Differential land use tax	Differential land use charges
Fresh water resources	Municipal bonds	Water rights	User charges	Subsidies for water conservation and irrigation		Sewage and effluent charges
Land resources	X	No titles for land clearing Secure land ownership		Agriculturals subsidies Below-cost public land sale/lease	Property taxes Land use taxes Transfer taxes	Impact fees Waste disposal charges
Sustainable agriculture	Removal of interest rate ceilings	Secure land ownership	Water pricing	Water subsidies Agrochemical subsidies	Agrochemical taxes IPM subsidies	
Atmosphere			Energy pricing	Energy subsidies	Energy taxes	Emission charges
Oceans		200-mile EEZs				Effluent charges
Hazardous waste			X	X		Presumptive charges
Toxic chemicals			X	X	Taxes on chemicals	Feedstock charges
Solid waste			X	X		Collection and disposal charges
Radioactive effects						
Health	X					
Urban environment	X				Property taxes Relocation incentives for industry	Pollution charges
Biotechnology	X					

	Innovative instruments		Policy integration	
Sector	Domestic innovative mechanisms	Global innovative mechanisms	Environment and economy	Domestic and international
Sustainable development	Eco-labelling Eco funds	Joint implementation		
Biodiversity	Bioprospecting fees Ecotourism fees Scientific tourism fees	Patents Intellectual property rights TCCs		
Forest resources	Watershed charges Tradeable reforestation credit	Tradeable forest protection obligations Carbon offsets		
Fragile ecosystems	Relocation incentives TDRs	TCCs		
Fresh water resources	Tradeable water shares	Water trading across borders		
Land resources	Betterment charges Differential land use charges			
Sustainable agriculture	Differential land use charge Eco-labelling	International sustainability standards/price premiums Carbon offsets		
Atmosphere	Tradeable SO_2 emission permits	Tradeable CO_2 permits Carbon offsets Carbon taxes Air travel tax		
Oceans	ITQs	Oil spill bonds		
Hazardous waste				
Toxic chemicals				
Solid waste				
Radioactive effects				
Health				
Urban environment	Betterment charges TDRs Tradeable emission permits, TDQs			
Biotechnology		Bio-prospecting Profit sharing		

TDR: transferable development right; TCC: tradeable conservation credit; ITQ: individual tradeable (fishing) quotas.
