

# Report from the Arctic Council Project Support Fund Expert Group - Agenda Item 8

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Ministry for Foreign Affairs of Iceland

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# Report from the Arctic Council Project Support Fund Expert Group

September 2004

## 1. Background

1. The Senior Arctic Officials have in a series of meetings discussed questions related to the mobilization of financing for Arctic Council projects. The discussions took a specific direction when ACAP in 2003 presented a proposal to consider establishing an Arctic Council fund to facilitate project financing. This concept has been explored in discussion papers that have been presented to the SAOs, the latest at their meeting in Selfoss on May 4-5, 2004. In the process a number of questions and concerns have been raised and clarified but so far a final decision has not been made whether to proceed with the initiative.

## 2. The Expert Group

2. At the meeting in Selfoss, the SAOs decided that the further perusal of the proposed Arctic Council Project Support Fund should involve a review of the concept by an ad hoc Expert Group. All Arctic Council members were invited to appoint experts.

3. The Expert Group has had the following composition:

Laura Kakko, Ministry of Foreign Affairs, Finland  
Ann-Britt Ylinen, Ministry of Environment, Finland  
Per Døyle, Norwegian State Pollution Control  
Lars Eklund, Swedish International Development Authority  
Bob Dyer, US Environmental Protection Agency  
Harro Pitkänen, NEFCO

4. The terms of reference for the group were defined by the SAO Chair as follows: "The task of the group of experts is to outline and explain the set-up of an Arctic Council Project Support Fund, develop draft operating guidelines, as well as a template for subscriptions, for demonstrative purposes."

5. The Expert Group has had 3 meetings. The first meeting discussed various conceptual issues related to the financing of project preparation and investment in the context of Arctic cooperation and identified a number of key questions relating to a project support fund. The second meeting discussed the contents of the group's report and draft operating guidelines for a fund. The third meeting discussed and approved the report and a template for a fund management contract.

6. In order to outline and explain the set-up of an Arctic Council Project Support Fund, the Expert Group has focused on the tasks and functions, the structure in relation to the Arctic Council and the decision-making procedure.

### 3. Tasks and functions of a Project Support Fund

7. The Expert Group finds it important that an Arctic Council Project Support Fund would have a clearly defined purpose, which demarcates its activities in relation to other funding mechanisms in order to avoid overlaps. In this way the fund would more easily establish an identity of its own, facilitating fund raising as well as relations to project sponsors and other stakeholders.

8. Essential elements in such a profile should be that the fund

- exclusively provides financing to Arctic Council projects;
- only works with specific projects, not various program activities; and
- stresses financing of project preparation and to a lesser extent the implementation of demonstration projects.

9. Arctic Council projects means projects that have been expressly defined and approved through the procedures applied by the Council (cf. chapter 4 below).

10. Specific projects refer to concrete, investment-oriented projects, i.e. actions, limited in time and scope, with a determined cost estimate and a defined, measurable result. The fund should not be a source of financing of general Arctic Council activities, such as the operating costs of Arctic Council programs or the costs for participation in Council activities. In the initial phase the fund could focus on environmental pollution abatement and prevention projects.

11. Focusing on project preparation will give a high return on the fund's interventions, provided that financing from other sources can be arranged for subsequent implementation measures. The preparatory phase of a project is frequently in need of external expertise and resources, which project owners are not able to finance. The preparation process involves several steps, starting from project identification and concept development, followed by studies required to demonstrate the project's viability and to provide the basis for decision-making (depending on the project this may involve pre-feasibility studies, feasibility studies, environmental impact assessments, business plans, financing plans, preliminary design etc.). In some cases also the tendering process, if applicable, for goods and services (preparation of tender documents, tendering and evaluation) needs external support. The Project Support Fund would typically finance expert consultants and associated costs.

12. Although the main focus should be on project preparation there are situations where the fund should have the possibility to provide support for the implementation phase of pilot and demonstration projects. Such support could expedite and facilitate the execution of priority projects through timely financing of critical components. Well-targeted implementation support can from time to time also play a crucial role in mobilizing other financing for the project. The fund could in these cases finance certain supplies of equipment and services.

13. In order to increase the efficiency of the Funds assets, it could, in the implementation phase, in addition to grants also work with revolving instruments such as concessional (soft) loans or contingent grants (which have to be repaid if the project achieves its goals). This would give a possibility for recycling a part of the fund's capital. Projects that have the potential of repaying all or part of the investment, but

where uncertainties at the time of investment preclude them from mobilizing normal debt and/or equity financing, would be suitable targets.

14. The fund should have an experienced fund manager in charge of daily operations. A practical way of setting up a fund is to establish in connection to an international financial institution, which agrees to hold the funds in trust and to be responsible for their management in accordance with the agreed guidelines. When selecting the fund manager attention should be paid to the experience of the institution in handling similar tasks, its familiarity with the operating region and ongoing activities to avoid overlaps, and its involvement in the types of projects that are relevant in the Arctic Council context.

15. The role of the Fund Manager will be to propose to the contributors, on the basis of its experience, the optimal way in which the fund could participate in a given case. The manager will also be responsible for the execution from the fund's side of the various steps involved in the financing by the Project Support Fund such as preparation of terms of reference, tendering for consultants or supervision of the procurement process for equipment and services.

#### **4. Structure in relation to the Arctic Council and its bodies**

16. As stated above it is important that an Arctic Council Project Support Fund is closely linked to the decision making process of the Council. First and foremost this implies that the fund should only finance projects that have passed through the project selection and approval process in the Council. In practical terms this means that projects will be identified and selected in the same way as today, proposed by Arctic Council Working Groups (at which time usually a lead country or countries are also appointed), endorsed and prioritized by the Senior Arctic Officials and ultimately approved by an Arctic Council Ministerial meeting.

17. With regard to project execution the Senior Arctic Officials and the Arctic Council Working Groups would retain the same functions as today, and the practice of appointing a project specific Steering Group would continue as usual. The new element would be that at the point when a project requires financial resources, the Project Steering Group could also request the Project Support Fund to provide funding. The decision if, and to what extent, the fund would participate in an individual project is, however, to be made by the fund itself in accordance with the procedures described below in chapter 5, on the basis of the merits of the specific proposal. An illustrative project flow chart is attached to this report ([Attachment 1](#)).

#### **5. Decision making procedure**

18. In the opinion of the Expert Group it is desirable to establish a simple and light structure for the Project Support Fund. In order to achieve the purposes of the fund there is no need to create a new institution or to establish a fund structure with institutional features. On the contrary, for some potential contributors such arrangements may imply an obstacle. Also, the Arctic Council or its members should not be required to take on any new roles.

19. A common practice is to set up a fund as an assignment to manage monetary contributions by one or more contributors. This takes the form of a contract between the contributor and the Fund Manager whereby the latter undertakes to manage the funds in accordance with a set of agreed guidelines. The guidelines will define the mandate of the manager as well as other aspects in relation to the contributor. When several contributors are involved the same contractual relation is established with each of them, and the guidelines will contain provisions on collective decision-making. In practice the contributors' representatives convene (in an assembly referred to, for example, as a "PSF Committee") from time to time to discuss and decide on matters related to the fund

20. In the process of setting up a Project Support Fund it would, however, also be important to establish an Arctic Council identity for the fund, through, for example, an official endorsement of the fund concept by the Arctic Council, welcoming the establishment of the fund and approving the purpose and general principles of the fund's operations. Furthermore the set-up of the fund could be submitted to the Senior Arctic Officials for their endorsement.

21. Establishing a Project Support Fund would be based on voluntary, individual contributions. Due to the nature of the fund it appears to be advisable to restrict the group of potential contributors to Arctic Council members and observers unless the Arctic Council decides to broaden the participation. Member and observer countries could in parallel continue with their bilateral activities, whether they are participating in the fund or not.

22. Preferably the fund should be set up as an open fund, meaning that contributors pool their resources without requiring any earmarking or tying of procurement in respect of the allocations from the fund. Procurement policy should be based on international practice implying transparent competitive bidding procedures (for smaller contracts simplified procedures, such as local shopping, may apply). However, it would also be possible to work with earmarked funds if so required by contributors. For example, geographical preferences may have to be taken into account.

## **6. Conclusions of the Expert Group**

23. The Expert Group concludes that a Project Support Fund is a mechanism that could provide value added to the Arctic Council in several ways:

- A joint fund would enhance the process of identifying, mobilizing and transferring financing for priority Arctic Council projects approved by the SAOs and Ministers, as there would be a pool of resources specifically designated for that purpose. Acting through a joint fund would also, without any additional effort, ensure concerted action;
- Setting aside financial resources in a Project Support Fund would ensure swift and timely response to the needs of the individual projects, contributing to an uninterrupted and effective project process;
- Contracting the services of an experienced Fund Manager would bring in specific project financing competence and create a competence centre for the financing of Arctic Council projects.

24. In the view of the Expert Group, a Project Support Fund established and operated in accordance with the principles outlined above, would be a simple and effective way of meeting the present and foreseen future needs of Arctic Council project

activities. A fund as such would not change the competences, modalities or division of labour in the Arctic Council as it would only streamline and enhance the existing fund raising practices.

25. It is important for a Project Support Fund to have sufficient capitalization in order to play a meaningful part. Although a fund should by definition seek to minimize its own input, restricting it to interventions that are necessary to move projects forward in a desirable way, this nevertheless calls for a critical mass of resources. Otherwise the fund will not be able to generate concrete results. Furthermore the operations of a fund will entail some costs. The Expert Group therefore recommends that the target be set to reach an aggregate fund capital equivalent to EUR 3 million over a three-year period.

## **7. Funds Administration Contract**

26. In addition the Expert Group has, in accordance with the terms of reference, developed an illustrative draft funds administration contract for a fund of this nature including a template for a contribution confirmation (Attachment 2).

27. Subsequent to endorsement by the Arctic Council, the fund would be established by the Fund Manager. Arctic Council members and observers would then be invited to pledge contributions. These would be formalized through the funds administration contract, which commissions the Fund Manager to manage the funds on behalf of the contributors.

### Attachments:

1. PSF Project Flow Chart
2. Illustrative draft fund management contract for a Project Support Fund

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