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SUSTAINABLE NORTHERN DEVELOPMENT
THE CASE FOR AN ARCTIC DEVELOPMENT BANK

ALAN GILL AND DAVID SEVIGNY

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Cover Image: Aurora Borealis over the village Katterjåkk and Lake Vassijaure in the north of Sweden, 200 km north of the Arctic Circle.

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TABLE OF CONTENTS

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ACRONYMS

AfDB	African Development Bank
AsDB	Asian Development Bank
BRICS	Brazil, Russia, India, China and South Africa
CDB	Caribbean Development Bank
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
GEF	Global Environmental Facility
IDB	Inter-American Development Bank
IFC	International Financial Corporation
IBRD	International Bank for Reconstruction and Development
MDB	multilateral development bank
NDB	New Development Bank
RDB	regional development bank

PREFACE

by John Higginbotham

The Arctic program at the Centre for International Governance Innovation (CIGI) focuses on the cutting edge issue of North American Arctic marine corridors and sustainable economic development in the context of the melting Arctic icecap. The program evaluates the effectiveness of multilateral, Canada-US, national, regional and indigenous peoples' governance in addressing these and other Arctic opportunities and challenges.

Through a series of high-level stakeholder round tables and a joint conference with the Center for Strategic and International Studies in Washington, DC on the future of the Arctic Council (staged in close cooperation with federal and other governments), CIGI has stimulated expert and public interest in developing new policies and programs for a changing Arctic.

One clear conclusion of this action-oriented research is that Canada's Arctic is neglected in terms of marine transport and related infrastructure. The latter is broadly defined as including icebreakers, modern charting, harbours and deep water ports, aids to navigation, search and rescue and oil spill mitigation response capacity. The livelihood of northern peoples and the development of mineral resources and marine tourism are constrained because of these serious marine infrastructure deficits. Other Arctic infrastructure areas — community energy, surface transport and communications — also suffer serious deficits in Canada.

CIGI's research preceded the *2014 Fall Report of the Commissioner of the Environment and Sustainable Development* (Office of the Auditor General of Canada),* which noted that Canada, and specifically the federal government, was simply not ready for the increase in Arctic shipping already taking place and certain to grow.

"Sustainable Arctic Development: The Case for an Arctic Development Bank" offers an excellent review of multilateral development banks (MDBs), and a fresh perspective on how to contend with this striking lack of Arctic infrastructure without overburdening limited national budgets.

Alan Gill and David Sevigny examine the evolution of various MDBs in flowing private capital through the trusted multilateral mechanism to projects that stimulate development, but are too big, risky, long-term or widely beneficial for the private sector or governments to manage on their own. This paper describes the variety of these international financial mechanisms and their adaptability to changing circumstances, including new types of partnership with the private sector.

Beyond the arguments set on in this paper, there are, of course, other avenues of research that could additionally be explored. These include:

- How is the Arctic Region defined?
- What governance structure could embrace the interests of all developed countries prepared to guarantee collective investment in Arctic development for the broader good, while respecting the economic sovereignty and environmental regulations of the developed Arctic countries, the interests of their northern inhabitants and distinctive environmental regulations and process?
- Should a MDB be linked organically to the Arctic Council states, with or without indigenous people and observer state membership?
- When might relations with Russia improve to the extent it would consider such a MDB if it involved unwelcome multilateral oversight of their environmental and social policies?

While no single MDB or related model will easily answer the problem of Arctic infrastructure, there may be key lessons for the Arctic within this family of institutions. This is well worth examining in greater detail. The hope is that this paper will launch a dialogue between multilateral financial experts and Arctic specialists regarding if the success and advantages of MDBs can be applied to the unique Arctic region and help meet its massive requirement in the coming decades for new public infrastructure and private investment.

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* This report is available on the Auditor General of Canada's website at www.oag-bvg.gc.ca/internet/English/parl_cesd_201410_e_39845.html.

EXECUTIVE SUMMARY

The creation of the multilateral development bank (MDB) model represents one of the most ingenious financial innovations in recent times. Initially designed to address the problems of financing reconstruction after World War II, this model has shown itself to be surprisingly adaptable to meet a range of other challenges. These have included fostering developing country growth, dealing with the developing world debt problem and facilitating the transition of countries within Central and Eastern Europe from centrally planned to market-based economies.

More recently, shareholders have tasked MDBs to tackle issues such as environmental sustainability, good governance and advancing the United Nations Millennium Development Goals. In addition, these banks have been asked to broaden their lending activities beyond member governments and their agencies to work directly with the private sector. The success of the World Bank, the first example of an MDB, has led to the establishment of a number of similar institutions at the regional and sub-regional levels.

Given their effectiveness and flexibility, it is reasonable to consider whether the MDB model might be adapted to help tackle some of the enormous challenges confronting the Arctic. Among the most critical of these are the promotion of responsible resource development, safe Arctic shipping and sustainable circumpolar communities. The MDB's experiences outside the Arctic in these areas suggest a new MDB focusing exclusively on the Arctic may be able to make useful contributions.

This paper reviews the evolution of the MDB model, examines its applicability to current challenges in the Arctic and discusses the possible establishment of a "Arctic Development Bank" that could raise significant new funding and advance environmentally sustainable development in the Arctic region. The paper concludes with a brief summary of several innovative governance features, which may be incorporated into the design of such a development institution, and key questions to consider prior to its establishment.

INTRODUCTION

This paper discusses the MDB model and how it might be adapted to support sustainable development in the Arctic region. The paper focuses on the use of the MDB model as a vehicle to raise much needed capital for critical infrastructural investments and discusses the MDBs' adaptability to a range of developmental challenges.

While, the MDB model is usually associated with promoting development in developing countries, it has also been used to finance a range of infrastructure needs in developed countries. During periods of fiscal restraint, many developed countries have also turned to a range of other innovative financing arrangements, including increasingly popular public-private partnerships, to meet their resource needs.[1]

In addition to the capacity to mobilize additional financial resources and to flexibly adapt to a range of emerging real-world challenges, there are other important advantages that the creation of a new MDB for the Arctic region could bring. These include: increasing cooperation in the region, which is often characterized by contested territorial claims; improving coordination of the broader development efforts of the region; ensuring new development efforts in the region meet the highest international standards of environmental sustainability; providing a forum to both monitor the ongoing development of the region and ensure appropriate transparency and accountability; promoting a more conducive environment for risk-sharing; and providing institutional mechanisms to allow non-Arctic governments and the private sector to participate meaningfully in Arctic development. A more detailed discussion of these other issues is beyond the scope of this paper.

THE MDB MODEL

Over the years, policy makers have generated surprisingly innovative solutions to an array of complex real-world problems. One of the most ingenious of these was the creation of a new type of special purpose financial institution — the MDB — to help fund international development.

As necessity is often the mother of invention, the idea for such an institution arose from the crucible of crisis. The MDB model was created from one of the most daunting crises of the past century — the reconstruction of Europe and Asia following World War II. The enormity of this challenge required new ways of thinking and new institutions that were capable of operating in ways the institutions of that time could not.

To recover from the devastation of World War II, the war-torn economies of Europe required enormous amounts of new capital and investment. The enormity of these financial needs far exceeded the capacity of international capital markets to mobilize resources. While private sector lenders were able to provide access to some of this financing, the unprecedented scale of these postwar needs resulted in significant financing gaps.

In response to this situation, the architects of the new postwar economic order came together at the Bretton Woods Conference in 1944 to create two new financial

1 Public-private partnerships are attractive because governments provide only part of the required financing for these projects with the remainder provided by the private sector. The use of MDB financing is similarly attractive because governments are required to provide little or no direct financing, with the bulk of the project funded by borrowings from international capital markets.

institutions — the International Monetary Fund and the World Bank.[2] The International Monetary Fund was tasked to rebuild the world's international payments system and promote improved international monetary cooperation. The World Bank was established to support the reconstruction and development of member countries in need by facilitating greater access to capital and increasing the effectiveness of investments for productive purposes.

The World Bank was the world's first MDB and has served as the model for many similar institutions that have followed. Perhaps its most innovative feature is its capital structure. The capital structure of the World Bank (and other subsequent MDBs) was designed to combine relatively small amounts of government cash (in the form of "paid-in" capital) with significant government guarantees (in the form of "callable" capital) to leverage considerable new borrowings on international capital markets.[3]

The World Bank then reloaned these market borrowings to member countries in need of capital.[4] Private sector lenders were willing to lend to the World Bank (despite the fact they would not directly lend to its borrowing member countries) because its government shareholders were jointly and severally responsible for the repayment of these loans in full and on time. In addition, given that these borrowings were guaranteed by the world's strongest economies, the World Bank was able to borrow from international capital markets at the lowest available market interest rates.[5]

BOX 1 — PAID-IN AND CALLABLE CAPITAL

The World Bank requires its shareholder governments to contribute two kinds of capital to backstop its continuing operations. Paid-in capital is provided in the form of usable currencies, which are liquid and convertible. Callable capital is provided in the form of promissory notes, which are contingent liabilities shareholder governments accept in the event that the World Bank needs additional capital to repay bondholders (rather than to meet administrative or programming needs).

The World Bank uses these capital resources as collateral to borrow on international capital markets. Under its articles of agreement, its borrowings cannot exceed its capital stock. This ensures its borrowings on international capital markets are fully backed by the World Bank's own resources, and, as a result, ensures its ability to borrow at the best possible rates (i.e., this underpins its triple-A status). This condition also assures World Bank lending and other financial operations are subject to rigorous commercial discipline.

As the World Bank's loan portfolio grows, its "headroom" to make new loans declines. When this headroom reaches a certain minimum level, the World Bank usually approaches shareholders to begin discussions on a capital increase, which will raise its lending capacity.

The loans extended by the World Bank to borrowing countries were more likely to be repaid (than similar loans extended by private lenders) for three reasons. First, the World Bank was able to require borrowing countries to take certain actions as a condition for receiving its loans. This "conditionality" included a range of policy changes and reform measures that strengthened the capacity of these countries to repay the loans received and hence improved their longer-term creditworthiness. Second, these borrowing countries were members of the World Bank and so tended to give priority status to the World Bank's loans over those of other creditors.[6] And third, in the event a borrowing country failed to repay loans, it would not only be precluded from further borrowings from the World Bank, but might also be subject to additional punitive measures by other shareholder governments.[7] None of these levers were available to private sector lenders.

2 The World Bank's original institution was the International Bank for Reconstruction and Development (IBRD), which continues to be its main lending agency for loans to middle-income and creditworthy low-income countries. The World Bank has subsequently expanded to include four additional affiliates — the International Development Association, the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency and the International Centre for the Settlement of Investment Disputes.

3 The IBRD's initial capital stock was US$10 billion composed of 20 percent paid-in capital and 80 percent callable capital. Paid-in capital was in the form of US dollars, gold and the domestic currency of the member country. Callable capital was a guarantee to pay additional capital should this be required to reimburse bondholders. Because the IBRD's lending practices were seen to present no default risk, the paid-in and callable capital contributions of member countries were deemed to be virtually riskless and so have no budgetary cost. For a detailed review of the financial structure of the MDBs, see Mistry (1995), and for the budgetary treatment of MDB capital, see Nelson and Weiss (2014).

4 The World Bank reloaned these funds at its own borrowing costs plus a small administrative fee. This was much lower than the cost at which borrowing member countries could access capital markets (if they could access them at all). The World Bank continues to raise most of its funds in international bond markets and through private placements.

5 The World Bank's articles of agreement limit its outstanding loans to capital to a 1:1 gearing ratio. This ensures loans are fully backed by shareholder equity. By comparison, private lending institutions frequently operated at 10:1 ratios or higher (see Mistry 1995).

6 This is sometimes referred to as "preferred creditor status."

7 For example, this might take the form of exclusions from borrowing on key national capital markets.

BEYOND POSTWAR RECONSTRUCTION

The early success of the MDB model in catalyzing significant amounts of additional financing to help rebuild the European economies created an impetus to use this model to address other challenges, such as the scarcity of available funds for economic development in many developing countries.[8] As in the case of reconstruction efforts in many postwar countries, the economic weaknesses of many developing countries meant private sector lenders had serious reservations about lending to these borrowers.[9] Moreover, when these countries were able to access funds, they were often only able to do so at exceptionally high interest rates.

In much the same way that the World Bank was able to raise additional funds for the reconstruction of European countries, it was also able to raise money to be reloaned to developing countries to promote economic growth and development. Over time, this intermediation had the additional effect of helping to broaden and deepen international capital markets. In part, this was achieved by demonstrating to the private sector that the risks of lending to certain countries, and for certain types of projects, were manageable, and these loans were therefore not as "risky" as they may have initially appeared. As private sector lenders became more comfortable with these types of lending arrangements, the World Bank gradually "backed out" and left the private sector to provide increasingly larger proportions of these loans over time.[10]

DEVELOPMENT LENDING

As the World Bank gained experience and came to better understand the needs of its developing country members, it realized the challenges facing these countries extended beyond their access to international capital markets. In fact, many of the development projects in these countries were simply not commercially viable, and would remain unviable, regardless of how efficiently the World Bank could intermediate and reloan the funds it had borrowed on capital markets. These projects were simply unable to generate the commercial cash flows necessary to repay the money these countries borrowed at market rates. In some cases, this was because the rate of return on projects was far below market interest rates. In others, the payback period was significantly longer than the time frame for which private sector lenders were comfortable committing financing.[11] In practice, this meant even the lowest market-based interest rate was often too high for many of these countries to realistically repay.

In response to this situation, the World Bank approached industrial country shareholders to create a new lending facility (the International Development Association) that could provide the poorest developing countries with interest-free grants rather than market-rate loans. This concessional financing was better adapted to the repayment capacity and longer-term development prospects of many of these countries. As a result, the World Bank's "soft loan" window was able to provide its poorest members with grant financing that charged a zero rate of interest and was repayable over 50 years.[12]

ESTABLISHING REGIONAL MDBS

The success of the MDB model led to a growing interest in the possibility of establishing similar institutions at the regional level. These regional development banks (RDBs) differed from the World Bank in that the regional borrowing member countries dominated their governance structures. Many of these institutions were also headquartered in the region and largely staffed by nationals from the region. It was argued that this allowed these regional institutions to be more responsive to the special needs of their borrowing members.

The first RDB to be established was the Inter-American Development Bank (IDB). It was created in 1959 in response to the desire of Latin American countries for a financial institution more attuned to their needs (as well as growing US concerns about the spread of communism in Latin America). Unlike the World Bank, the IDB initially focused the bulk of its lending on social projects rather than large infrastructure projects. However, over the years, its lending has evolved such that a substantial share of its current lending is now directed to large infrastructure projects.

8 Nelson (2013) notes that the Marshall Plan provided many European countries with significant additional new funding, which might have provided additional impetus for the World Bank to shift the focus of its lending toward developing countries.

9 The World Bank made its first reconstruction loan to France in 1947. Subsequent loans were extended to Denmark, Luxembourg and the Netherlands. The World Bank extended its first development loan to Chile in 1948. For more detailed historical information (World Bank Group 2013).

10 These "co-financing" arrangements required both the World Bank and private lenders to assume a portion of these loans on their own books.

11 For example, while the commercial rate of return on an education project in a developing country may appear low (as it does not result in an immediate increase in government tax revenue), the social rate of return (in terms of building a higher-skilled workforce, which raises longer-term growth) may be considerably higher.

12 The grant money that the MDBs receive from donor governments allows them to provide concessional financing for projects that are not commercially viable, but have important developmental impacts. As the grant money that donor governments give the MDBs will not be returned to them, it has a budgetary cost.

The next RDB was the African Development Bank (AfDB), which was established in 1964 with a mandate to advance sustainable economic development and the social progress of its regional members. For the first two decades, the AfDB was an exclusively African institution.[13] This reflected the desire of African governments to promote stronger unity and cooperation among the countries of the region. However, the AfDB now has a significant non-regional membership, a trend also reflected in other RDBs.

The Asian Development Bank (AsDB) was established in 1966 with a focus on regional cooperation. Unlike the IDB, it was mandated to advance large infrastructure projects, rather than social projects. In its early years, the AsDB focused on lending for agriculture and energy infrastructure. Member countries were convinced such projects were critical to removing the bottlenecks that inhibited rapid economic growth in the region.

The European Bank for Reconstruction and Development (EBRD) was established in 1991. It was mandated to ease the transition of the former communist countries in Central and Eastern Europe and the former Soviet Union from planned economies to free-market economies.[14] The EBRD differs from the other regional banks in two key respects. First, it has an explicitly political mandate that only allows it to operate in countries that demonstrate a commitment to the principles of multi-party democracy, pluralism and market economics. And second, the majority of the EBRD's lending is explicitly directed toward the private sector rather than supporting projects of member governments.[15]

The newest of the MDBs is the aptly named New Development Bank (NDB), established by the five BRICS (Brazil, Russia, India, China and South Africa) countries in 2014. The NDB was designed to mobilize supplementary resources for infrastructure and sustainable development projects in the BRICS, other emerging economies and developing countries. This bank will have an initial capital stock of US$50 billion, which will grow to US$100 billion over time.[16] Unlike the other MDBs, the NDB was also created with a US$100 billion "reserve fund" to help member and other countries manage future balance-of-payment crises.[17]

EVOLVING PRIORITIES

Looking back on the postwar years, the World Bank and RDBs have shown a remarkable ability to adapt and respond to a range of evolving challenges.[18] In its earliest years, the World Bank's loans were largely earmarked for income-producing infrastructure projects, such as seaports, highways and power plants that generated sufficient funds to allow their borrowing members to repay these loans.

In the 1970s, the MDBs significantly increased the size and number of their loans and expanded their lending activities from infrastructure investments into a range of social programs such as health and education. In the 1980s, these institutions restructured their lending activities to help the international community manage the growing debt problem in the developing world. In part, this involved the use of newly designed structural and sectoral adjustment loans to help these debtor countries stabilize their economies and build stronger foundations for longer-term growth.

In the 1990s, as noted earlier, the MDBs supported the transition of former Eastern Bloc countries to more market-based economies.[19] More recently, the MDBs have assumed a more active role in areas such as environmental sustainability and the promotion of good governance as well as taking a leadership role in promoting global public goods and advancing the Millennium Development Goals.[20]

The MDB model's effective response to these challenges has spurred the creation of a number of sub-regional and other development institutions.[21] For example, the Caribbean Development Bank (CDB) was created to promote economic growth and development in Caribbean

13 All of its initial shareholders were governments of African countries.

14 The brief description of these regional institutions draws on the work of Nelson (2013). For a broader examination of the differing character of these institutions, see Culpeper (1997).

15 Under its charter, the EBRD is required to direct 60 percent or more of its financial commitments to private sector enterprises (or state-owned enterprises, which are in the process of privatizing their operations).

16 The NDB's initial capital stock will consist of 20 percent paid-in capital and 80 percent callable capital. For additional commentary of the rationale for the bank's creation, see Culpeper (2014), and for analysis of possible incompatibilities in its operations, see Hochstetler (2014). The NDB is expected to begin lending operations in 2016.

17 In October 2014, twenty-one countries agreed to establish an Asian Infrastructure Investment Bank with an initial capital stock of US$100 billion to help meet the enormous infrastructural needs of the Asia-Pacific region. China originally proposed this new bank partly in response to its concerns about the slow pace of governance reforms in the World Bank and AsDB. The bank's articles of agreement are expected to be completed in 2016.

18 For a discussion of the shortcomings of the MDB model from the perspective of borrowing member countries, see Buira (2005).

19 The brief description of how these institutions evolved draws on the work of Mistry (1995).

20 Efforts to promote global public goods include efforts to control communicable diseases such as HIV/AIDS, malaria and tuberculosis.

21 The sub-RDBs include a range of institutions such as the Caribbean Development Bank (CDB), the Central American Bank for Economic Integration, the East African Development Bank, the West African Development Bank, the Black Sea Trade and Development Bank and the Eurasian Development Bank.

member countries and advance economic cooperation and integration.[22] The CDB was designed to complement the World Bank and IDB in raising supplementary financing to meet the special problems facing small island economies, such as high production costs (associated with limited economies of scale) and poorly diversified exports (due to small export bases).[23]

ENGAGING THE PRIVATE SECTOR

Another evolution of the MDB model has been the shift from providing financing exclusively to borrowing governments (and their agencies) to lending directly to the private sector. As in the case of earlier loans extended to government borrowers, many of these investments involved the kinds of risks international capital markets were initially reluctant to take. These loans were typically associated with projects that were not only seen to have considerable commercial risks, but also significant development benefits.[24]

In structuring their lending, the MDBs were able to show more flexibility than private sector lenders. For example, they were able to provide funds with longer grace and maturity periods than private sector lenders. Working together, an MDB and private lender could therefore jointly co-finance a larger loan with a longer maturity period than the borrowing country might otherwise have been able to access on international capital markets.[25]

The extension of the MDB model to the private sector has also had the advantage of increasing the transparency and accountability of many private sector projects. For example, a standard condition of MDB lending is that each funded project must undergo a rigorous environmental assessment and be subject to ongoing monitoring. Thus, MDB participation can help ensure the environmental consequences of a project are comprehensively assessed and, where significant environmental impacts are identified, mitigation strategies are explicitly identified and rigorously implemented.

BOX 2 — EUROPEAN INVESTMENT BANK

The European Investment Bank (EIB) was established in 1958 to advance European integration and social cohesion. The member states of the European Union are its shareholders. The EIB generally provides about a third of the financing for each of its projects. This supportive financing encourages public and private sector partners to provide risk finance that might otherwise not be forthcoming.

The EIB's priorities include financing for strategic infrastructure, such as the development of trans-European transport and energy networks and promoting environmental sustainability. These projects must comply with strict economic, technical, environmental and social standards. In addition to financing, the EIB provides administration and project management capacities, which facilitate investment completion.

Not surprisingly, the World Bank was the first MDB to establish a private sector affiliate. In 1956, the IFC was established with a mandate to advance economic development by investing in commercial projects that reduce poverty and promote sustainable growth.[26] The IFC does this by providing developing countries with financing for private sector projects, assistance in mobilizing international capital and a range of technical assistance. Subsequently, other RDBs have established similar private sector affiliates. As indicated above, the EBRD is explicitly required to extend at least 60 percent of its loans, guarantees and equity investments to private sector borrowers.[27]

The MDB model has been adopted by a number of other institutions, such as the EIB, which primarily lends to developed European countries.[28] This general shift in emphasis to engage the private sector more actively reflects the evolution of thinking about the importance of the private sector in promoting economic growth and sustainable development.

22 The Caribbean countries are members of the World Bank, the IDB (a regional MDB) and the CDB (a sub-regional MDB).

23 The CDB arose from a recommendation of the Canada-Commonwealth Caribbean Conference in 1966 to study the possibility of establishing a financial institution to serve the Commonwealth Caribbean region. The subsequent study recommended the establishment of a CDB with initial capital of US$50 million.

24 For example, the building of a road paid for by the higher tax revenues that a government is projected to receive from increased economic activity.

25 For example, if a private sector lender were unable to provide a loan of more than 15 years for a certain project, the MDB might be willing to provide co-financing in the form of a 20-year loan, which extends the overall term of the loan an additional five years beyond what the private sector lender alone could offer.

26 To avoid "crowding out" private sector lenders, the IFC is only to provide financing when sufficient financing is not available on reasonable terms from other private sector lenders.

27 This stands in sharp contrast with other MDBs, which primarily extend loans to borrowing governments and their agencies.

28 For example, the EIB is funding the Crossrail project in the United Kingdom, which is Europe's largest infrastructure project. When it is completed in 2018, it will increase the size of London's rail network by 10 percent.

THE ARCTIC CHALLENGE

The key question for this paper is whether the MDB model can be constructively adapted to help tackle the special challenges of sustainable development in the Arctic. CIGI has published several studies that review a number of these key challenges in detail.[29] These are also aligned with the critical priorities identified by the Canadian government at the beginning of its Arctic Council Chairmanship in 2013.

Among the most important challenges are those related to the urgent need for responsible resource development, safe Arctic shipping and sustainable circumpolar communities. Progress in each of these areas will require extensive new investments in critical infrastructure. As noted above, this is not only a central feature of the operation of all MDBs, but the explicit rationale for the establishment of both the AsDB and the NDB.

The specific infrastructure needs of the Arctic include new and improved road and rail networks, deep water port facilities, airports and runways, geological surveys and topographical data. The lack of this infrastructure has seriously inhibited oil, gas and mineral exploration and presents a significant obstacle to the expansion of safe shipping. This lack of development has also considerably slowed the growth of sustainable Northern communities.

Currently, resource development in the North is dominated by mining activity. However, there is also rapidly growing interest in the oil and gas sectors.[30] The MDBs have extensive experience working with governments and the private sector in the extractive industries. The focus of this work has included areas such as stronger governance structures and improved monitoring of environmental and social performance.

Another priority area for sustainable development is safe shipping. With the continued thaw of the Arctic ice cap, new polar shipping routes such as the Northern Sea Route and the Northwest Passage are receiving greater attention. In addition to improved navigational charts and stronger polar shipping codes, sustainable Arctic development will require additional investments in deep water ports and improved harbour facilities. The MDBs have had broad experience in working with governments and private partners on a wide range of port development projects and in mitigating the construction, operation and environmental risks associated with such projects.

BOX 3 — GLOBAL ENVIRONMENTAL FUND

The Global Environmental Fund (GEF) was established in 1991 as a US$1 billion World Bank program to protect the global environment and promote environmentally sustainable development. A year later, it was restructured as an independent organization. The governance structure of this new organization significantly enhanced the involvement of developing countries in the decision-making process.

The GEF provides grants and concessional financing to cover the "incremental" costs of transforming a project with national benefits into one with global environmental benefits. It is designed to finance projects, which have elements relating to climate change, biological diversity, international waters, land degradation, ozone layer depletion and persistent organic pollutants.

The GEF's membership includes more than 180 national governments, international institutions, civil society organizations and private sector participants. The GEF Council, the main governing body, functions as an independent board of directors and meets twice a year.

Finally, a successful development strategy for the Arctic needs to advance the growth of sustainable circumpolar communities. In part, this will require indigenous communities to be engaged and consulted in the projects and strategies that affect them. Here again, the MDBs have long-standing experience in working with indigenous peoples and ensuring their interests are reflected in the development projects that they help finance.

In addition to undertaking rigorous social impact analyses, the MDBs require an informed consultation process for all projects that have significant effects on indigenous peoples. They also require these projects to clearly demonstrate social and economic benefits for these groups and that appropriate measures are taken to safeguard their cultural and heritage institutions.

The MDBs are also open to pursuing innovative approaches to promote environmentally sustainable development. The establishment of the GEF is a case in point. The GEF, initially established as a lending facility within the World Bank, was designed to provide additional funding to existing private sector projects to cover the incremental costs of integrating stronger environmental protections into these projects. In this way, the GEF was positioned to improve the environmental sustainability of each project that it financed.

29 See Higginbotham, Charron and Manicom (2012), McCallum, Sheiban and Stawicki (2013) and Higginbotham and Grosu (2014).

30 As is widely cited, the US Geological Survey has estimated the Arctic contains about 15 percent of the world's undiscovered oil and 30 percent of its undiscovered gas, see The White House (2013).

MDB GOVERNANCE STRUCTURES

Most MDBs have adopted similar governance models. Their member countries are their primary shareholders and the voting power of each country is a function of the size of its shareholding, which generally reflect its economic strength and importance in the region.

The highest decision-making authority of an MDB is its board of governors. Each member country appoints a governor.[31] The board of governors meets annually, but may have inter-sessional meetings or make decisions through electronic or mail-in votes. While the board of governors is responsible for all major decisions, it delegates the authority for day-to-day decisions for policy, lending and administrative matters to its board of directors. The executive directors, who sit on the board, represent a constituency of one or more member countries.

In the case of the World Bank, the board of directors has 25 executive directors. As they are smaller institutions, the RDBs operate with smaller executive boards. The executive directors are generally resident in the country in which the MDB is located and usually are required to meet at least once a week to oversee their institution's activities. Board decisions are generally reached by consensus and then implemented by the president and staff of the institution. The president is elected by the board of governors and is responsible for the overall management of the institution.

BOX 4 — THE ARCTIC COUNCIL

The Arctic Council was established in 1996 to address issues of importance to the governments and indigenous peoples of the Arctic region. The Arctic Council has eight country members (Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden and the United States). There are also representatives from six indigenous peoples' organizations (the so-called "permanent participants," which include the Aleut International Association, the Arctic Athabaskan Council, the Inuit Circumpolar Council, the Gwich'in Council International, the Russian Association of Indigenous Peoples of the North and the Saami Council) and observers from other non-Arctic governments, intergovernmental and interparliamentarian groups and non-governmental organizations.

The permanent participants are consulted on the Arctic Council's agendas, participate in their discussions and are able to propose projects. However, they do not formally vote on the Council's decisions. The Arctic Council focuses considerable attention on issues such as environmental protection and sustainable development. Working groups have undertaken studies in areas such as climate change, oil and gas exploration and maritime safety in the Arctic region.

AN ARCTIC DEVELOPMENT BANK

An Arctic Development Bank might choose to adopt a governance structure broadly similar to that of the other MDBs. For example, in determining its initial member governments, an Arctic Development Bank might use the IDB model by replicating the membership structure of another Arctic institution.[32] In this case, the Arctic Council appears to be the most logical choice. Alternatively, if the Arctic Development Bank wished to maximize its share capital and access to international capital markets, in addition to the members of the Arctic Council, its membership might be expanded to include non-Arctic governments (for example, Arctic Council observers), which have a demonstrated commitment to promoting sustainable Northern development.

The voting power of each member could be determined through negotiations to reflect their economic strength and importance in the region. Governing structures of an Arctic Development Bank could also include a board of governors, which would be responsible for major decisions, a board of directors, with responsibility to oversee the institution's day-to-day activities, and a president, who would be responsible for the overall management of the institution.

An Arctic Development Bank might consider a number of innovative features. For example, similar to the EBRD, its charter might require a fixed percentage of its lending to be directed to certain specific types of projects. In the case of an Arctic Development Bank, it could require that a specific percentage of loans directly benefit indigenous peoples in the region and its operations are seen to clearly advance sustainable economic growth in Northern communities.

Consideration could also be given to expanding the governance structure, beyond member country governments, to provide the Arctic Council's permanent participants with a formal voice in the institution. One way to do this would be to replace the "simple majority" voting system, which is used for most MDB executive board decisions, with a "double majority" system. Under such a system, a project would require the support of both a majority of member country governments and a majority of permanent participants before it could be formally approved.

31 In Canada's case, the minister of finance is the governor of the World Bank and the EBRD. The minister of foreign affairs is the governor of the other RDBs.

32 The initial shareholder governments of the IDB were the member countries of the Organization of American States.

In a similar vein, consideration might be given to the possibility of allowing private sector companies that are active in the region to formally participate in the institution. And finally, an Arctic Development Bank could explore the merits of a non-resident board of directors, which would significantly reduce operating costs by conducting most of its business through electronic rather than in-person communication.

CONCLUDING REMARKS

This paper briefly discusses the possibility of establishing a new MDB for the Arctic region. It argues the MDB model has certain features that may lend themselves to helping address the special challenges of this region. Specifically, the MDB model has been proven effective in raising significant amounts of supplementary financing on international capital markets at relatively low costs to governments. It has also shown itself adaptable to meet many of the challenges that are now identified as critical priorities for sustainable Northern development. In addition, the multilateral character of these institutions has been effective in bringing different shareholder governments and other interested parties together to pursue common developmental objectives.[33]

A number of critical issues will still need to be addressed. Among these are the membership and regional character of the institution, its size, capital structure and the location of its administrative headquarters. Our hope is that the arguments in this paper will provoke discussion among Arctic Council member countries, and underscore the value of a more detailed study of the costs and benefits of such an institution and its possible role in promoting more sustainable Northern development

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33 The risk of uncoordinated development poses serious risks for resource extraction, maritime safety and community development in the Arctic.

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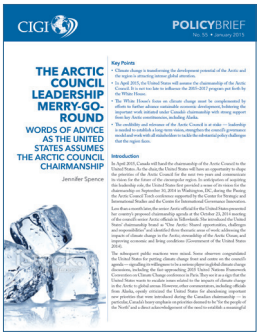
Geophysical developments in the Arctic will challenge and disrupt traditional patterns of Arctic governance at the global, regional, bilateral, national, sub-national and local levels, a shockwave that carries profound implications for shipping routes, on- and offshore resource and economic development, international trade and investment patterns, territorial definitions and disputes, local communities, international security and national and international politics.

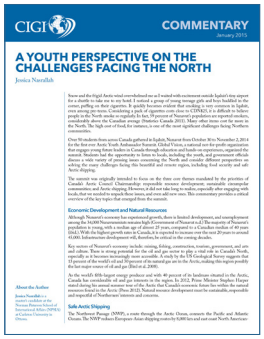
This CIGI project is premised on the idea that strengthened governance is the key to containing chaos and achieving order in the New Arctic. Keeping existing governance mechanisms and strategic interests in the region in mind, CIGI researchers work with national and international experts to explore the best possible outcomes of the "great melt" and what new bilateral and multilateral relationships, challenges and opportunities may evolve from newly accessible resources and territories.



The Arctic Council Leadership Merry-go-round: Words of Advice as the United States Assumes the Arctic Council Chairmanship

CIGI Policy Brief No. 55
Jennifer Spence

The US Arctic Council chairmanship begins April 2015, and it is not too late to influence its program. The focus on climate change must be complemented by efforts to further advance sustainable economic development. Leadership is needed to establish a long-term vision for the Arctic.



A Youth Perspective on the Challenges Facing the North

CIGI Commentary
Jessica Nasrallah

Over 50 students from across Canada gathered in Iqaluit, Nunavut from October 30 to November 2, 2014 for the first ever Arctic Youth Ambassador Summit. This commentary provides a critical overview of the key topics that emerged from the summit.

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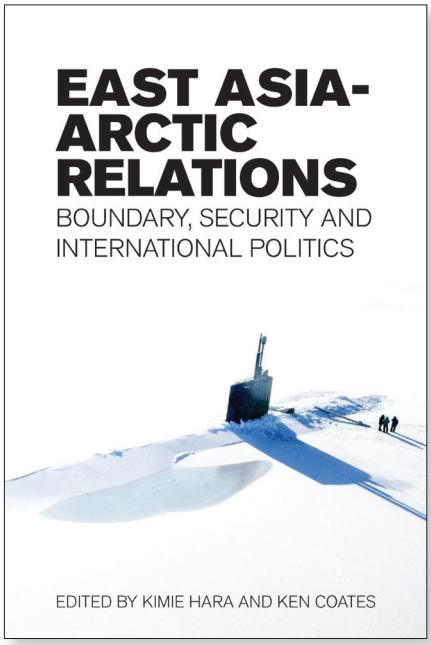

East Asia-Arctic Relations: Boundary, Security and International Politics
Edited by Kimie Hara and Ken Coates

Paperback: $28.00;
eBook: $14.00

The Arctic's profile as a region for opportunity and engagement is rising among both circumpolar and non-circumpolar states. Canada, Russia and the United States have expressed a renewed interest in the region, and East Asian countries such as Japan, South Korea and China are now increasingly fixated on prospects offered by the Arctic; however, Arctic and East Asian nations have not yet engaged in extensive discussions about competing and complementary activities and responsibilities in the Far North. This volume is an outcome of an international collaborative project that launched a focused and detailed conversation about the historic, contemporary and future dimensions of East Asian countries' relationships and interests in the Arctic. Bringing together leading experts from Japan, China, South Korea, Russia, the United States and Canada, it draws policy-making and scholarly attention to East Asia's growing interests in the Far North, and identifies political, economic, legal and security connections between the two regions.

ABOUT CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's current research programs focus on three themes: the global economy; global security & politics; and international law.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

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