

North American Development Bank (NADBank)

| FY2002 Appropriation | FY2003 Request |
|---------------------------------|---------------------------|
| \$0 | \$0 |

The North American Development Bank (NADBank), and its sister institution, the Border Environment Cooperation Commission (BECC), were chartered under the auspices of the North American Free Trade Agreement (NAFTA) to assist border communities in addressing the serious environmental problems in the U.S. - Mexican border region. NADBank is funded equally by the United States and Mexico and started operations in FY1995. It provides financing (i.e., loans, guarantees, and grants) for environmental infrastructure projects that have been certified by the BECC and are located within 100 km of either side of the U.S. - Mexico border. Under their joint Charter, BECC and NADBank may only develop, certify, and finance environmental infrastructure projects.

Although NADBank has total authorized paid-in capital of \$450 million, to date, it has approved only \$23.5 million in lending. In response to this inadequate performance, the U.S. and Mexican governments began considering options to improve the performance of both institutions in 2000. In late 2000, the Boards of BECC and NADBank agreed to expand their activities into new sectors to give the Bank more lending opportunities. In addition, the NADBank's board created new financing mechanisms, including a \$50 million Lower Interest Rate Lending Facility (previously called the Value Lending Program). Implementation of these initiatives is underway.

Further reflecting disappointment over BECC/NADBank performance, in September 2001, President Bush and Mexican President Vincente Fox called for fundamental reforms to improve the performance of both institutions. They tasked a binational working group to consult with key stakeholders and develop joint recommendations for the Presidents. In late March 2002, President Bush and President Fox accepted the recommendations of the working group on strengthening both institutions.

As BECC and NADBank continue to address urgent environmental needs in the border region, both governments will implement the reforms, which include replacing the two institutions' separate boards of directors with a single board, making financing more affordable, expanding the institutions' geographic scope on the Mexican side, and greater efforts to finance private sector environmental projects. The U.S. Administration will continue to consult with stakeholders as the reforms are implemented.

For FY2002, the Administration is not requesting any funding for NADBank. Congress has appropriated the full \$225 million in U.S. paid-in capital and authorized the full \$1.275 billion in U.S. callable capital.

NOTE: NADB Fiscal Year: April 1- March 31

Internet website: www.nadb.org

Key Facts

- NADBank was created with \$450 million in total paid-in capital and \$2.55 billion in callable capital, to be subscribed equally by Mexico and the United States. To date, Mexico and the United States have contributed a combined total of \$348.8 million to NADBank. The U.S. Congress has authorized and appropriated the full amount of the United States' remaining capital contribution.
- Ninety percent of NADBank's total capital is dedicated to financing environmental infrastructure projects in the border region. The remaining 10% is allocated to separately operated domestic programs in each country that assist communities in adjusting to the displacement of workers caused by trade liberalization. In the United States, the program is called the Community Adjustment and Investment Program (US CAIP).
- Through the Border Environmental Infrastructure Fund (BEIF), NADBank provides grant financing for water treatment and wastewater treatment projects in either country. To date, this program has been 100% financed by separate appropriations to the U.S. Environmental Protection Agency (EPA), which has allocated \$336 million to the BEIF.
- During 2001, the NADBank Board approved the first two grants for solid waste projects, one in each country, through the Bank's Solid Waste Environmental Program (SWEP), a program created in 1999 that is funded out of retained earnings. NADBank is developing grants for eight additional projects that are expected to be eligible for approval in 2002.
- As of end-2001, the NADBank had recommended, and EPA had approved, BEIF grant financing for 34 projects in both countries totaling \$330 million. Of this, \$82 million had been disbursed. The NADBank Board had approved a \$23.5 million in loans to 8 projects and \$1 million in SWEP grants. Of this, \$10.5 million had been disbursed.
- NADBank also funds technical assistance programs under its Institutional Development Cooperation Program (IDP), which trains utility managers and enhances the ability of communities to built, operate and maintain infrastructure projects sustainably.

November 2000 Reforms

In response to NADBank's poor lending record, NADBank's Board of Directors approved a set of policy measures aimed at increasing NADBank's financing activities; namely: expansion of the Bank' activities into new sectors, creation of a lower interest rate lending program, authorization for management to recommend equity investments for Board consideration, and creation of a technical assistance program for solid waste project development.

Expansion into New Sectors

In November 2000, the NADBank Board decided to expand the range of environmental infrastructure sectors in which the Bank finances projects, and in December the BECC Board decided to expand its project development and certification work in the same manner.

- The new sectors identified by the NADBank and BECC Boards for involvement include, but are not limited to, air quality improvement, water conservation, hazardous waste reduction and mitigation, public transportation, and clean energy.
- To date, BECC and NADBank have conducted public outreach to identify a set of initial projects that would be eligible for certification and financing in the near term. Both institutions have received many concepts for projects, but only five project sponsors have submitted “Step 1” applications for BECC certification.
- To date, the NADBank Board has approved about \$250,000 in technical assistance funding for work in the new sectors, including feasibility studies for 6 potential projects in the areas of water conservation, air quality, renewable energy, and infrastructure planning. Additional technical assistance efforts are under consideration.

New Financing Mechanisms

The NADBank Board endorsed two initiatives to give NADBank new financing tools.

- The Board authorized the creation of a Lower Interest Rate Lending Facility (LIRLF), previously called the Value Lending Program, which will be funded with \$50 million in paid-in capital. This program will charge interest rates that while lower and more affordable, will still be sufficient to maintain the value of the committed paid-in capital.
- The Board approved the operating guidelines for this facility in October 2001, which take into account three considerations: (1) the program should primarily benefit poorer border communities, (2) the program should not crowd out private investment, and (3) interest rates should cover projected inflation and administrative costs as well as project risk.
- The guidelines for the LIRLF establish different eligibility criteria based on a borrower’s credit rating. Non-creditworthy communities, which generally have lower per capita incomes, will be able to borrow at lower interest rates than credit-worthy communities, which generally have higher per capita incomes. (For more detail, refer to: http://www.nadbank.org/english/program_service/Loan/loan2_frame.htm.)
- The Board also authorized NADBank Management to propose for Board consideration individual equity investments in environmental infrastructure projects, on a case-by-case

basis, which would be funded out of retained earnings. NADBank management is examining projects in which the Bank could take an equity stake in the future.

Further Reform Efforts

In September 2001, President Bush and President Fox announced their agreement that “immediate measures were needed to strengthen the performance” of NADBank and BECC in identifying and funding “environmental infrastructure projects on the border.” Presidents Bush and Fox asked that a binational working group consult with national legislatures, border states, communities, and other stakeholders and report back with joint recommendations on how to improve both institutions. The working group held bilateral discussions and conducted separate stakeholder consultations in each country. The U.S. Government agencies involved (Treasury, EPA, and State Department) held a series of meetings with the general public, non-governmental organizations, and local officials in border cities in each of the four border states (Arizona, California, New Mexico, and Texas) to gain their input. The USG agencies also met with representatives of each of the four border state governors and briefed Congressional staff on the initiative.

The Presidents accepted the recommendations of the working group and have directed both governments to work with their legislatures to implement them. NADBank and BECC will remain focused on environmental infrastructure priorities and will continue their urgent work on projects as the recommended reforms are implemented. The key recommendations are as follows:

- Geographic Scope: To expand the capacity of both institutions to address important binational environmental needs, the geographic scope for BECC/NADBank operations in Mexico should be expanded from 100 km to 300 km from the border. This expansion would be coupled with a system of financial differentiation that concentrates grants and low interest rate loans for projects in the poorest communities located within the current border region of 100-km, in both countries. The geographic limit in the United States would remain unchanged at 100-km from the border.
- Financial Instruments: To provide a greater level of financial flexibility so that its capital can be used more effectively and creatively, NADBank should expand its ability to extend concessional financing by doubling its Low Interest Rate Lending Facility and increasing its capacity to provide grants out of its own resources.
- Organizational Structure and Process: To improve functional coordination and operational efficiency between BECC and NADBank, the two boards of directors should be replaced by a single board to oversee both institutions. This new board would have representation from the federal governments, the border states, and the public. At the same time, a comprehensive business process review should be initiated to identify ways to improve overall project design, certification, and implementation.
- Private Sector: To expand the tools available for financing projects that, among other things, mitigate industrial pollution, improve air quality, and recycle and reuse wastes, a more concerted effort should be made to certify and finance private sector environmental projects.

How NADBank Supports U.S. Objectives

Preventing Pollution Flows into the United States

NADBank projects directly benefit the United States by reducing the flow of raw sewage and other pollutants into the United States and into shared water bodies. For example, NADBank is providing \$22 million in loan and grant financing for construction of sewage collection and

Strengthening Relations with Mexico

The NADBank has functioned as a partnership in which both countries have worked together to address shared problems in a mutually advantageous manner. NADBank contributes to improved growth prospects for Mexico by aiding structural reform in Mexico through utility service pricing reforms, support for decentralization, and facilitation of greater private sector participation in infrastructure.

Increasing Productivity

NADBank projects alleviate many of the significant health problems afflicting the border region, which contributes to improved worker productivity. In addition, NADBank's technical assistance programs improve efficiency at utilities and contribute to increased human capital in the border region.