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The North American Development Bank

Introduction

The North American Development Bank (NADB) is a binational financial institution created and funded by Mexico and the United States. The NADB provides loans and grants to public and private entities for environmental and infrastructure projects on both sides of the U.S.-Mexico border. Modeled after the multilateral development banks (MDBs), such as the World Bank, the NADB has a unique environmental focus and is the only development bank that also finances projects in the United States.

Origins and Mandate

The NADB was created under the auspices of the North American Free Trade Agreement (NAFTA) in 1994, through a binational side agreement between the United States and Mexico. It was created to address some policymakers' concerns that NAFTA could worsen environmental conditions in the border region as economic activity increased. The NADB's financing activities initially focused on projects related to water supply, wastewater treatment, and municipal solid waste disposal. In recent years, the NADB expanded its financing activities to include air quality, such as financing the development of wind farms for the generation of electricity.

NADB-eligible projects must be located within 100 kilometers (about 62 miles) north of the U.S.-Mexico international boundary in the U.S. states of Texas, New Mexico, Arizona and California, or within 300 kilometers (about 186 miles) south of the border in Mexico. Projects beyond these limits may be deemed eligible under certain conditions and subject to approval by the NADB's Board of Directors.

Funding

In January 2015, then-President Obama and Mexican President Enrique Peña Nieto agreed to support a doubling of the NADB's capital base, from $3 billion to $6 billion, subject to the necessary legislation and availability of appropriations. The proposed capital increase requires an additional $450 million in paid-in capital and $2.55 billion in callable capital, split equally between both countries. Both countries have pledged to take their individual paid-in capital to a total of $450 million by 31 December 2022.

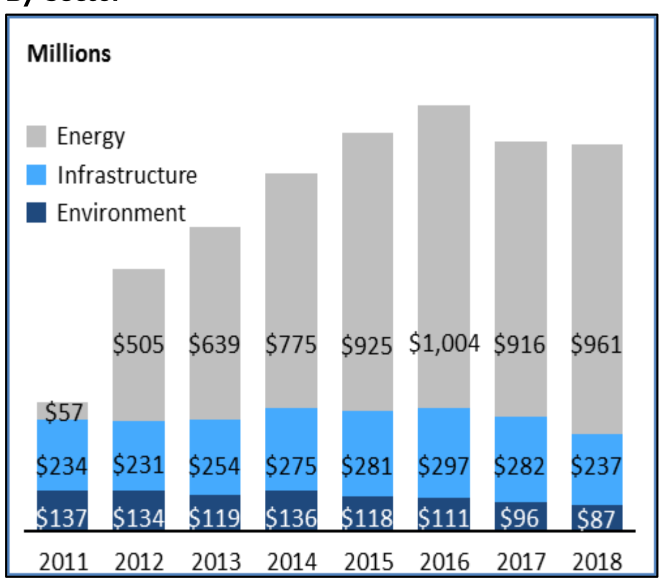
Like other MDBs, callable capital may be called if and when required to meet the Bank's debt or guarantee obligations, subject to certain procedural requirements, and may not be used to make loans. The NADB leverages its position by issuing debt in international capital markets.

The capital increase is motivated by the Bank's substantial increase in lending over the past five years, which has strained its capital adequacy ratios. Additionally, a change in credit rating agency methodology requires the NADB to maintain higher capital adequacy ratios than other MDBs. NADB financing is also more concentrated than other MDBs, because, by mandate, projects are geographically constrained to the border region and targeted in specific sectors. The proposed capital increase has also raised policy debate about the future of the NADB more broadly. Some analysts question the continuing need for NADB financing two decades after NAFTA was created, and whether it is crowding out private sector financing. Other analysts argue that the NADB is critical to supporting needed environmental and infrastructure projects in the border region that would not be otherwise funded by private investors. Some analysts further call for the NADB to expand its activities beyond the border region and to all of Mexico.

Lending

During the Bank's early years, much of its lending capacity was underutilized. In the Bank's first decade (1994-2004), outstanding loans remained below $100 million. In 2000, the NADB Board expanded the range of projects that the NADB could invest in beyond water and solid-waste management into a wide range of environmental infrastructure projects. In 2004, President George W. Bush signed legislation (P.L. 108-215), that authorized the NADB to expand its geographic jurisdiction and make grants and non-market rate loans out of its paid-in capital resources with Board approval.

Figure 1. NADB Outstanding Loans: Over Time and By Sector



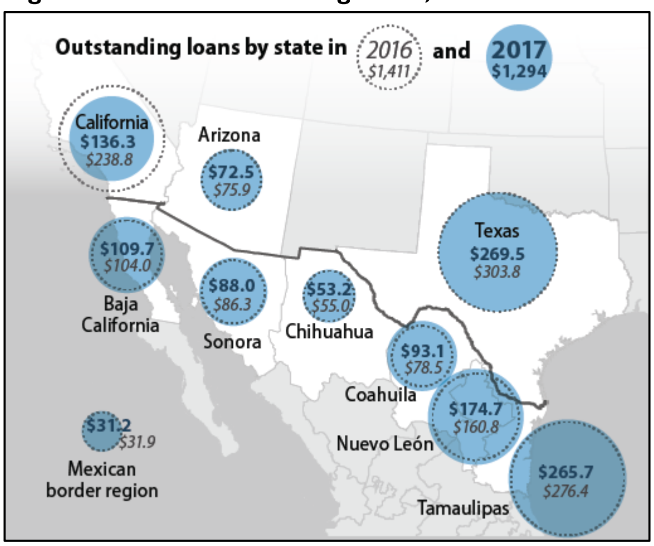
Source: Created by CRS from NADB Annual Reports.

NADB approved $138.1 million in financing in 2018. This included $131.7 million in loans, $4.1 million in grants, and $2.3 million in technical assistance. Since 2011, NADB loans increased sharply through 2016 due to substantial growth in wind and solar investments, declining moderately in 2017 and 2018 (**Figure 1**). According to Moody's, consolidation in the renewable energy sector led to lower interest costs and greater availability of financing alternatives. As a result, firms that had borrowed from the NADB were able to secure alternative financing and prepay their outstanding NADB loans. Energy sector and environment sector loans recovered in 2018. Environment sector loans, however, have continued to decline.

In recent years, the Bank's portfolio has become concentrated in wind and solar energy projects. In 2018, wind and solar loans accounted for 77% of the NADB's outstanding loan portfolio. Public transport, by contrast, accounted for only 3% of the outstanding loans.

While the NADB provides loans to nine of the ten states allowed by its mandate, the top three states in which it lends, Texas, and the Mexican state of Tamaulipas, account for 58% of the NADB's portfolio (**Figure 2**). In total, 56.2% of outstanding NADB lending is in Mexico, compared to 43.8% in the United States. According to the Bank, NADB lending in Mexico covers a broader area of sectors than in the United States, where borrowers have more financing options.

Figure 2. NADB Outstanding Loans, Millions of USD



Source: NADB Annual Report, 2018.

NADB Governance Structure

The NADB works closely with the Border Environment Cooperation Commission (BECC), created concurrently with the NADB. Originally separate entities, the two organizations merged in 2017. Whereas the NADB focuses on project financing and oversight for project implementation, the BECC focuses on technical, environmental, and social aspects of project development. Before a project can be financed by NADB, it must be certified by the BECC as technically and financially feasible. The NADB and BEEC are governed by a ten-member Board of Directors with equal U.S. and Mexican representation on the Board. The chairmanship alternates between the United States and Mexico each year. All powers of the NADB are vested in the Board of Directors, which determines policy and approves the Bank's programs and financing proposals involving NADB funds.

U.S. Legislative Action

In FY2016 and FY2017, the Obama Administration requested authorization for U.S. participation in the capital increase, up to $1.5 billion to meet the U.S. share (contributions were pledged to be split evenly between the two countries). While recent appropriations bills have provided some funding toward the U.S. contribution to the NADB capital increase, they have not included the requisite authorization for U.S. participation. Specifically, the *Consolidated Appropriations Act, 2016* (P.L. 114-113) did not include the requisite authorization language for U.S. participation in the capital increase. It did, however, allot $10 million for paid-in capital and $255 million for callable capital to the NADB to remain available until expended.

On January 3, 2019, a bipartisan group of Texas representatives introduced H.R. 132, *the North American Development Bank Improvement Act of 2019*. In addition to authorizing U.S. participation in the capital increase, the bill directs the executive branch to pursue various policy reforms. These include targeting certain sectors, such as natural gas and construction of new international land border crossings. In addition, the legislation seeks to require the NADB to "develop and implement efficiency improvements to streamline and accelerate the project certification and financing process. These measures were incorporated in H.R. 5430, the United States-Mexico-Canada Agreement (USMCA) implementation bill, which was signed into law on January 29, 2020 (P.L. 116-113).

The USMCA legislation authorized U.S. participation in the capital increase and appropriated the remaining amount of U.S. paid-in capital toward the capital increase. However, the legislation did not include authorization for the Unites States to subscribe to additional callable capital. The FY 2016 appropriations act included a program limitation to subscribe to up to $255 million in callable capital, resulting in a shortfall of $1.02 billion. The Trump Administration has requested authorization for the remaining callable capital in the FY2021 international programs request.

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