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# The North American Development Bank

## *Forging New Directions in Regional Integration Policy*

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While the North American Free Trade Agreement (NAFTA) has been recognized as the most ambitious attempt to establish free trade across the wide income gap between rich and poor countries, few are aware that the political struggle around NAFTA also produced the North American Development Bank (NADBANK), a new type of institution designed for democratically based regional planning and international leveraging of public/private financing.[1] A grassroots effort of Latino community and environmental groups created NADBANK to facilitate the financing of environmental infrastructure and economic development projects on the United States-Mexico border as well as in other communities needing adjustment assistance because of NAFTA. The success of such institution building to expand the scope and distribution of public and private investments will have decisive implications for whether North America will be able to generate environmentally sustainable and socially equitable integration.

## The North American Challenge

The task of building a pattern of equitable and sustainable development in North America will face two major challenges: wide income, productivity, and infrastructure gaps, both within and between countries; and in both countries, a lack of institutional structure to manage uneven development.

Mexico and the United States already share the highest level of economic integration between the most unequal pair of rich and poor neighboring countries of anywhere in the world. Mexico-United States interdependence includes the largest trade relation and the largest debtor-creditor relation between any two developed and developing countries; the largest foreign investment flows; the largest in-bond coproduction relations (maquiladoras); and the longest contiguous border with the highest levels of border crossings and border commerce, both legal

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and illegal. Migration, however, is actually much more important economically to both countries: as an eager source of migrant low-skill labor needed for United States growth; and as a source of foreign exchange through remittances, for Mexico. The border is a metaphor for the challenge embodied where the first world meets the third world: the most internationally integrated region of each country exists at the intersection of the greatest disparities between geographical neighbors anywhere in the world.

NAFTA is the most ambitious attempt to integrate a highly developed economy with a developing economy. Development disparities are much wider between North American countries than between any other group of countries that have attempted to integrate their economies. Countries within the European Union and the European Free Trade Association started with far smaller differences in per capita (and total) GDP than what exists between Mexico and the United States.

Income distribution disparities *within* the United States and Mexico are also much wider than those within member countries of the European union. An important element in United States income inequality is the widening gap between the incomes of White Americans and those of Latino and other minority populations, both United States born and immigrant.[2] Regional income gaps are very wide within each country. The income gap between Mexico's rich northern border and the southern state of Chiapas is wider than the difference in average income between Mexico and the United States. The degree of income inequality is also high along the border region, which includes shantytowns and high technology plants in Mexico and in the United States' poorest counties, as well as in prosperous Southern California.

These differences in income and productivity are reproduced in the large regional and national differences in limited public sector financing of social and physical infrastructure investments. In an all too familiar vicious cycle, substantial differences in productivity and income limit the base for local taxes and user fees, thus limiting the local capacity to finance physical and social infrastructure, as well as the capacity of local institutions to sustain advances in the environmental and social regulatory regime; that in turn, limits productivity and income potentials.

Accompanying this panorama of uneven economic development is the failure of institutions, including markets as well as governments, to direct long-term investments towards equitable and sustainable development. Despite the high degree of asymmetrical interdependence in North America, there has until recently been an almost complete lack o tional commitment to managing the interdepende between countries through policy coordination and institution building.

The border represents one of the clearest examples of a failure of market mechanisms to have local investments cover the externalities of strain on the environment and on instrastructure. Neither market nor regulatory mechanisms have been effective in having firms internalize these costs, in part due to the low margins of the technologically unsophisticated development strategy that has been common historically along the border. Movement towards higher productivity and higher income production, however, requires adequate infrastructure, which cannot be financed on local resources. Restrained local capital liquidity limits capital availability and raises local financing costs. Meanwhile, access to long-term financing through international capital markets is unavailable, in part because a lack of adequate mechanisms to cover political, financial and legal risks which thus limits private participation in local capital markets. These problems associated with the border can, of course, also be found in many communities in various regions that now face increased competition in the more integrated North American economy.

Governments on both sides of the border have been inefficient in addressing these market failures. The diffuse power relations in the United States, and the highly centralized bureaucracy in Mexico have together inhibited the formation of bi-national institutions with a focus on regional and, especially, border development. Neither country has provided the type of long-term public financing needed for infrastructure investments. In the United States, the border has been a low national priority. While in Mexico the border actually has received more funding than the rest of the debt-burdened country, financing of infrastructure is hampered there by a lack of legal frameworks for local governments to issue bonds against user fees or real estate taxes. The lack of democratic and participatory forums in local communities, a problem on both sides of the border, further inhibits the development of political and fiscal responsibility and the associated economic empowerment of those regions most in need.

## Alternative Scenarios of the Impact of NAFTA

What possible impacts may the North American Free Trade Agre ture course of United States-Mex policies are most likely to result in an equitable and sustainable pattern of mutually beneficial growth and integration in North America? Over the last three years, my colleagues and I at the University of California have been exploring these questions, using a variety of methodological techniques, from state-of-the-art computable general equilibrium modeling to various industrial regional and labor market case studies.[3] This research has revealed three options from which the United States and Mexico could choose: 1) NAFTA as originally negotiated in 1992; 2) A No NAFTA/Neo-Protectionism scenario; or 3) a NAFTA-Plus scenario with policies for sustainable and equitable growth.

While NAFTA by itself was shown to be very likely to enhance income and productivity in North America, especially for the more competitive firms, sectors and regions, free trade was also shown to be likely to cause major adjustments and widening inequality, particularly for the less competitive labor markets, sectors, and regions. A "Neo-Protectionist" anti-NAFTA scenario, on the other hand, was shown to be actually worse in terms of output, employment, and welfare, with no reduction in migration or inequality. Only a third policy scenario, one that combines NAFTA trade liberalization with policies to generate Mexican development and manage adjustment problems in both countries, could generate economy-wide output, employment, and more equitable wage growth on both sides of the border. Only with a substantially enhanced NAFTA, which establishes specific institutional mechanisms, can we hope to put North America on a new course that leverages the economic benefit of trade liberalization to serve the explicit goals of upgrading the environment and improving communities on both sides of the border.

## The NADBANK Approach to Regional Integration Policy

The NADBANK was initiated through a grassroots movement to institutionalize a policy forum with resources dedicated to addressing, from the perspective of local community and environment concerns, the long-term problems of North American integration. As a part of the NAFTA political battle, Mexico and the United States agreed to create NADBANK to finance environmental investments and regional adjustments related to NAFTA. The principal mission of NADBANK is to help finance environmental infrastructure and economic development projects, both on the United States-Mexico border and in other communities needing help with adjustments caused by NAFTA.

The capitalization of NADBANK has been set at $3 billion, with each country pledging to contribute half of the $450 million of paid-in capital and half of the $2.55 billion in callable capital. While NADBANK financing will concentrate on the area one hundred kilometers on either side of the border, the international agreement also allows for each country to use ten percent of its capital contribution to NADBANK to finance "domestic" economic adjustment to NAFTA, in communities away from the border. NADBANK will act as the lead bank in the financial packaging of border projects that have been environmentally certified by the Border Environmental Cooperation Commission (BECC). NADBANK "domestic" financing will coordinate with other programs and financial mechanisms available to national governments, to leverage NADBANK capital as much as possible. It has been conservatively estimated that the NADBANK funds can leverage project financing of more than $20 billion for border investments. The NADBANK United States domestic window has been constructed so as to make available up to $1 billion in federal financing for economic development, making NADBANK the largest community development banking resource yet established.

Through the NADBANK and the BECC advisory committee structures, both institutions will rely on a continuous flow of information and advice from local governments, community groups, and the private sector in the regions where NADBANK financing would take place. This participatory governance structure of NADBANK and the BECC is integral to the mission of these institutions: to develop a new type of responsive public financial entity and thus help to reshape the role of governments and multilateral development banks.

NADBANK establishes a forum for a three-way dialogue among essential forces: the NGOs representing the community constituents of the projects; the private sector institutions that are potential investors to be leveraged by NADBANK; and the national and local governments on both sides of the border, which must now learn how to combine and leverage their resources with NADBANK funds.

It is the potential ability of NADBANK to convene such a three-way forum, combined with substantial committed resources at NADBANK's disposal for leveraging additional public and private investment, that constitutes the promised usefulness of the NADBANK operation. NADBANK, working in conjunction with the BECC, will create an institutional forum where three major activities will take place:

1) Eligibility evaluation and ranking of projects according to their relevance to the environmental

and social priorities defined by local master plans. Crucial here will be the BECC, and the NADBANK advisory councils composed of various social actors from both countries, including local resident taxpayers, service users, service providers, and various government agencies.

2) Commercial evaluation and ranking of investment projects according to their internal rates of return and their economic feasibility. The risks of each project, ranging from exchange rate to political risks, must also be evaluated and priced. From estimates of the NADBANK funds likely to be needed to support each project's financial survival, priorities will have to be set to form a portfolio management plan. A portfolio must be assembled that both is consistent with a strategy of regional investments (including some projects needing relatively higher subsidies) and at the same time maintains the financial integrity of NADBANK.
3) NADBANK will then serve as the lead agency in putting together the financial packages for the approved projects, paying close attention to the dynamics of interactions between NADBANK, the state grantors, and the private sector interests. In this strategic negotiation to leverage as much additional financing as possible, NADBANK will have at its disposal a flexible array of financial institutions including credit enhancement, guarantees, direct loans, and equity participation.

Although NADBANK is now a legislated reality, much needs to be done to fulfill the tremendous promise of this unique and potentially trendsetting institution. Moreover, since NADBANK has been designed to transcend the traditional functions of multilateral development banks, no single expertise in either the public, the private, or the NGO sectors holds the answer to how the operation of such a catalytic entity can be organized.

## NOTES

1. The earliest published version of this proposal appeared as Albert Fishlow, Sherman Robinson, and Raul Honojosa-Ojeda, "Proposal for a North American Regional Development Bank and Adjustment Fund," in *North American Free Trade: Proceedings of a Conference* (Dallas, TX: Federal Reserve Bank of Dallas, June, 1991).
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3. Raúl Hinojosa-Ojeda, Sherman Robinson, and Goetz Wolff, *The Impact of a North American Free Trade Agreement on California: A Summary of Key Research Findings* (Southwest Voter Research Institute, 1992); Sherman Robinson, Mary E. Burfisher, Raúl Hinojosa-Ojeda, and Karen E. Thierfelder, "Agricultural Policies and Migration in a U.S.-Mexico Free Trade Area: A Computable General Equilibrium Analysis," Working Paper No. 617 (Berkeley, Department of Agricultural and Resource Economics, University of California at Berkeley, 1991); Raúl Hinojosa-Ojeda, and Robert McCleery, "U.S.-Mexico Interdependence, Social Pacts and Policy Perspectives: A Computable General Equilibrium Approach," in Jorge Bustamante, Clark Reynolds, and Raúl Hinojosa-Ojeda, eds., *U.S.-Mexican Relations: Labor Market Interdependence* (Stanford, CA: Stanford University Press, 1992); Raúl Hinojosa-Ojeda, and Rebecca Morales, "International Restructuring and Labor Marketing Interdependence: The Automobile Industry in Mexico and the United States," in Jorge Bustamante, Clark Reynolds, and Raúl Hinojosa-Ojeda, eds., *U.S. Mexican Relations: Labor Market Interdependence* (Stanford, CA: Stanford University Press, 1992); Raul Hinojosa-Ojeda, and Sherman Robinson, "Alternative Scenarios of U.S.-Mexico Integration: A Computable General Equilibrium Approach," Working Paper No. 609 (Berkeley, Department of Agricultural and Resource Economics, University of California at Berkeley, 1991); Raúl Hinojosa-Ojeda, and Sherman Robinson, "Labor Issues in a North American Free Trade Area," in Nora Lustig, Barry Bosworth, and Robert Lawrence (eds.), North American Free Trade: Assessing the Impact (Washington, D.C.: The Brookings Institution, 1992).