The World Bank and Inter-American Development Bank: Fit for 21st Century Purpose?

Nancy Birdsall

Abstract

In this paper I discuss the ownership and financial structure and related governance arrangements, including leadership selection, of the World Bank and the Inter-American Development Bank. I argue that the IDB, for various reasons, is farther along in making the shift from a model based on rich member countries financing charitable transfers to poor countries, to a model closer to that of a financing cooperative, along the lines that the founders of the World Bank envisioned at Bretton Woods. It is also better positioned to increase its engagement in the Latin America and Caribbean region in critical cross-border regional issues, where modest amounts of grant-based public financing in the form of subsidies and guarantees have the potential to leverage substantial private investment.

Center for Global Development
2055 L Street NW
Fifth Floor
Washington DC 20036
202-416-4000
www.cgdev.org

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I first set out briefly the urgent need for increased cooperation and collective action amongst sovereign states in dealing with cross-border issues and regional and global public goods in this century if sustained growth, poverty reduction and other development goals are to be achieved. I then describe the governance and financial structure of each bank and the differences between them in dealing with the tradeoff faced by most international institutions between legitimacy and effectiveness. Finally I suggest why – for both fundamental and fortuitous reasons – the history, rules and customs that have shaped the IDB's governance, norms and values are making it relatively easier for the IDB than for the World Bank to adjust to changing geopolitics.

The changing development landscape: the new geopolitics and global challenges in this century

The global financial crisis triggered by the fall of Lehman Brothers in 2008 and its aftermath in the following five years, have made visible and telling two new realities of the 21st century. First, the United States and its Western allies no longer represent the single canonical example of the economic and political model of a free market democracy that other countries ought to strive to imitate. The crisis was triggered in the United States, in part by a failure of monetary and financial regulatory policy. Moreover, many emerging market economies, including China, India and Brazil, recovered relatively quickly from the global crisis in part due to so-called heterodox policies inconsistent with those of the U.S. model (Birdsall and Fukuyama, 2011). Second, the global economy is less dependent on growth in the traditional Western democracies than it has been for many decades; growth in China and other emerging market economies fueled the global recovery in 2010 and is projected to exceed growth rates in the high-income countries for the next decade and beyond (IMF, 2013[1]). For the first time in over 100 years there is convergence between the per capita incomes of the richest countries and some of the large developing countries.

[1] The IMF provided country-specific projections through 2018 in its 2013 World Economic Outlook report. China is expected to grow at more than 8 percent in that period and the combined emerging and developing countries at almost 5.9 percent. The G-7 in that period is expected to grow at 2.2 percent. These projected rates are regularly updated; it is unlikely that over the next decade the G-7 economies as a group will grow at higher rates than the developing economies, if only because of such underlying factors as faster labor force growth in the latter.

A fundamental implication of these new 21st century realities is that global development can no longer be thought of primarily as a matter of financial transfers from rich to poor countries in order to reduce poverty. The world's poor are no longer concentrated in "poor" countries (Sumner, 2012) and the world's rich are no longer solely in rich countries (e.g., Rothkopf, 2008). In developing countries reductions in poverty will require dealing with the political and social roots of inequality at home and with attracting private inflows. Official transfers from abroad will matter less and less; indeed that is already the case (OECD, 2013; Greenhill et al., 2013). For most of the last century credit and capital flowed from the transatlantic powers to poorer countries; in this century, depending on market conditions, capital is as likely to flow "uphill" from developing to advanced economies – in part because it is the rich and not the developing world that is struggling with both high debt and the burden of aging populations. In short, rather than a matter of transfers from rich to poor countries, global development is now a matter of meeting, both internally and through cooperation, a set of challenges shared by all countries to manage a globally integrated and interdependent global market.

The cross-border challenges range widely from financial crises, volatile food prices, disease pandemics, policing of drug and sex trafficking, microbial resistance to drugs, and most critically – climate change. Many of these problems reflect classic failures of the market – as in the case with climate change and financial crises. Others reflect what might be called governmental failures – though in this context they can be thought of as failures of a weak and inadequate system of global governance (Birdsall, 2013).

In addition to classic market failures, there is the problem of inequality. There is no reason to expect the global market to be "fair" any more than is the case for domestic markets. Within and across countries, the market is inherently asymmetric, favoring the rich (Birdsall, 2006b). Growth based on deeper and more competitive global markets has been a key factor in reducing global poverty and in achieving convergence of average incomes in some emerging markets with those of the high-income countries. But within many countries market-led growth has increased income inequality. Where inequality has declined, including in much of Latin America, the evidence suggests increased spending on social programs and other government interventions has been the central force driving those declines (e.g., Lustig, Lopez-Calva, and Ortiz-Juarez in this volume).

Within countries, it is the function of the nation-state to use taxes, subsidies and its regulatory powers to deal with market failures – for example to force polluters to internalize the costs they would otherwise impose on others, or to offset initial inequalities (e.g., by financing broad-based access to schooling). Across countries, there is no equivalent to the powers of sovereign states. But there is a system of global governance in the form of various inter-governmental clubs (the G-7, the G-20) and institutions (the United Nations, the International Monetary Fund, the multilateral development banks), the logic of which is analogous: to compensate for initial and ongoing inequalities across nations and peoples and to deal with climate adaptation, financial and other market failures at the global level.

In principle, the international financial institutions – the IMF, the World Bank and the regional development banks – are well positioned to respond to the new realities of increased interdependence and shifting geopolitical power. They are institutions based on the idea of cooperation and collective action among sovereign states in their mutual shared interests – in the case of the IMF, of global financial stability; and in the case of the banks, of better-shared global prosperity. But in fact adjustment to the new reality, in which a group of large and rapidly growing emerging markets – including Brazil, Russia, India, China, South Africa (the BRICs) and others – are driving overall global growth, has not been easy, particularly for the World Bank and IMF. They were founded in the 20th century when the United States was the single largest military and economic power in the Western world, closely allied during the Cold War with the major economies of Western Europe. Their ownership structures and governance arrangements reflect their economic dominance, decades ago but not in the present reality of a much larger and growing proportion of global GDP held by the developing countries as a group.[2]

The continuing dominance of the West at the IMF and the World Bank – in voting power and effective control of the leadership and other senior positions – has weakened their legitimacy as representative institutions and, in the last two decades, has begun to undermine their effectiveness as settings for nations to cooperate on shared global financial and economic problems, as well as on such issues as energy, climate, food, trade, and exchange rates where the domestic decisions of China, Brazil and other large middle-income countries matter at the global level. The continuing dominance of the traditional powers has also had the effect of discouraging full engagement of the new emerging market powers in the policies and financing of the institutions themselves and in leadership choices, as will be outlined below – further reducing their ability to bring old and new powers together. Perhaps the best example is the accumulation of reserves by many emerging markets as self-insurance, following the Asian financial crisis in the late 1990s, in order to reduce their dependence on the IMF.

Another good example of the difficulty in adapting to new challenges has been the World Bank's inability to deal strategically with climate change despite the mounting evidence of its potential costs to growth and poverty reduction in the developing world (Steer, 2013). To do so adequately would require a new mandate and a new grant instrument explicitly targeted to financing climate programs and perhaps such other global public goods as agricultural and health research (Birdsall, 2012). A new mandate and instrument are required because the bank's key instrument, the country loan (guaranteed by the sovereign member borrower[3]),

[2] At market exchange rates, low- and middle-income countries accounted for about 30 percent of global GDP in 2010 (using the World Bank's income classification, August 2013), and just over 42 percent in purchasing power parity terms. Their share of global GDP has increased dramatically with the rapid growth of China and India in the last two decades and will continue to increase based on IMF projections. The anomalies in terms of quota (and voting shares), Board chairs and senior management appointments are most dramatic at the country level. For example, even with the recently negotiated increase in its quota, China will still have fewer than Italy and the United Kingdom combined; the European countries as a group have 8 of the 24 chairs on the IMF board and still control the selection of the IMF Managing Director; and the United States, though its quota is relatively low relative to its share of global GDP, retains an effective veto on key IMF decisions.

[3] This applies to the IBRD only. The International Finance Corporation (IFC) makes loans to private sector borrowers without the sovereign guarantee.

does not lend itself (literally) to addressing climate change; borrowers have no incentive to take on the additional costs of climate-friendly investments (in the absence of a global price on carbon) – the classic "free rider" problem associated with market failure. But a grant-based instrument to finance the incremental costs of power projects and the full costs of forest preservation, to take one other example, would compete for funding with the bank's existing periodic fund-raising for its concessional lending (the IDA) to low-income countries. A bureaucratic culture based on a long history of country-based lending and reluctance to create a separate program that would compete with IDA for scarce contributions have discouraged successive leaders from asking member countries for a new mandate.

More fundamental for the purposes of this paper, many developing countries along with many influential international NGOs have objected vociferously to the idea of an explicit role for the World Bank in dealing with the global climate problem, on the grounds that its policies and programs would not adequately reflect the needs and interests of the non-Western world. The issue of the overall legitimacy and representativeness of the bank has taken away any impetus from outside for the kind of mandate the bank could assume.

For whatever reasons, in the past decade, neither the World Bank leadership nor the board representing member countries have asked for the special new mandate and funding that could have put the bank in a leadership position on the climate agenda or in relation to other global public goods.[4] What has happened instead is that the traditional donors, led by the British, have supported trust funds at the World Bank (and the regional banks) to finance the incremental costs of investing in renewable and other low-carbon energy and related projects in developing countries – the Climate Investment Funds or CIFs. The creation of these and similar trust funds demonstrates the donors' confidence in the bank's fiduciary, legal and project development capacity, and their willingness to commit resources of their own for deployment by an institution that they view as capable and responsive to their demands. But the trust funds do not invite the broader strategic set of policy, research, monitoring and other activities on climate that would enable the full integration of climate and development priorities and tradeoffs within and across countries that the bank is ideally suited for as the world's premier global development institution.

In 2010, under the umbrella of the UN-sponsored climate negotiations, the international community agreed on the establishment of a new international institution, the Green Climate Fund, with the mandate to raise resources from member countries to channel via grants and loans to climate-friendly investments in the developing world. That Fund's governance, the outcome of many years of wrangling, ensures that developing countries have 50 percent of the votes as well as effective veto power on many decisions, promising "representativeness" and legitimacy in that sense. But it does not create a link between contributions by countries and their control over decisions. Thus, it is more in the spirit of one nation, one vote typical of some UN agencies, in contrast to the arrangements at the international financial institutions which link capital and other contributions to voting power. The lack of any link

[4] For more on this idea, see Birdsall and Kapur (2005) and Birdsall (2012).

invites the question whether the Fund's leadership will be able to raise adequate resources to perform its work from the traditional donors – or from China and other major emerging markets that, in the absence of substantial control over their deployment, may be reluctant to commit significant resources to the Fund.

I return below to the treatment afforded the apparent tradeoff between legitimacy and effectiveness, illustrated by the differences between the World Bank, founded in the 20th century, and the just recently established Green Climate Fund in the context of how that tradeoff has been better resolved at the IDB.

The governance and financial structure of the World Bank and the IDB

Three differences between the governance structure of the World Bank and the IDB have significant implications in their ability to respond effectively to the increasing influence of the emerging market countries and the increasing relevance of their domestic decisions (China on energy, Indonesia on forests, Brazil and India on the intellectual property regime for medicines) for the development prospects of other countries.

The first difference has to do with the voting power of the traditional creditor countries (the United States, Europe and others whose capital allows the banks to borrow at low rates) and the borrowing countries, which at both banks is closely tied to the amount of capital each member has contributed. The second has to do with the members' voice on the governing bodies; and the third with the influence of the traditional trans-Atlantic powers and its relationship to voting power and the selection process for the heads of the two institutions.

As Table 1 indicates, the creditor or non-borrowing member countries at the World Bank currently control 53 percent of the votes, and the borrowing members the remaining 47 percent. These shares reflect a change following protracted negotiations in the last five years; in 2008 the percentages were about 61 and 39 percent, respectively (with rounding). At the IDB, in contrast, the borrowers hold just over 50 percent of the votes and the creditors just under. The 50/50 split reflects the gradual increase, over several decades, in the voting shares of countries other than the United States, (the sole creditor when the IDB was founded in 1959). More recently, voting shares of both the United States and borrowers have been reduced to allow for the purchase of shares by new members from Europe and Asia. In 1994, when the member countries agreed to a major recapitalization of $40 billion doubling the size of the bank's capital, the United States reduced its shares by about 4 percent to about 30 percent.[5] (In 2010 the IDB members agreed to an additional capital increase shown in Table 1, without changing the 50/50 split.)

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[5] The ability for the World Bank and the four major regional development banks to borrow on the capital market is still grounded, for all practical purposes, on the non-borrower countries' capital commitments (paid-in and guaranteed) - in effect affording them, in some instances, greater influence than their voting power implies. However, because the entire arrangement on which these banks' financial structure is based would be permanently undone if the capital of a non-borrower were to be called, it is also the case that the capital markets pay attention to the inherent risks of the banks' lending.

In short, at the IDB, the borrowing member countries hold just over 50 percent of the equity or capital shares in the bank and therefore have a majority of the votes in the weighted voting system. Conversely, at the World Bank, the creditor countries hold the majority.[6]

The second difference is the issue of "voice" on the governing boards of the banks. This is relevant because while major decisions are influenced by voting power and by other forms of influence – including whether issues are brought before the board and in what form – most board decisions at the two banks are adopted by consensus, sometimes following extensive discussions. At the IDB, the 26 developing countries are organized in constituencies holding nine of the 14 board chairs. At the World Bank, borrowing countries are twice disadvantaged in terms of building coalitions to consider decisions brought before the board. First, many borrowing countries are members of a "constituency" – a group of countries represented by a single chair – in which a non-borrower dominates and normally controls the chair. Second, until 2010, just 12 of 24 board chairs were held by borrowing members. In that year, a new board chair was established to represent African countries (previously 47 sub-Saharan Africa countries had been formerly represented by just two chairs) so that developing countries now hold 13 of 25 chairs.

The third difference between the World Bank and the IDB is in the formal process for selection of the presidents of the two institutions. At the founding of the World Bank and the IMF in 1946, the Americans and the Europeans agreed to an informal pact guaranteeing their respective support for the Americans to name the president of the World Bank and the Europeans to name the managing director of the IMF. In the last decade there has been increasing pressure on the United States and the Europeans from developing countries and indeed from close observers and supporters of the institutions to yield on this privilege.[7] Indeed, the G-20 in its 2009 communique called for an "open, transparent and merit-based selection process" for the heads of the two institutions (though leaving out the wording "independent of nationality").[8] The selection process has indeed been increasingly open and contested; in the case of the World Bank, in the most recent 2012 selection, there were for the first time two non-American candidates formally nominated who openly campaigned for the position. The Obama Administration, however, was reluctant to cede the privilege the United States had held for decades, and was able to ensure the selection of its candidate, the current president, Jim Yong Kim. Kim was a strong candidate, but probably just as importantly - or more - only a few developing countries were willing to annoy the US administration, an ally and supporter on their critical commercial and security issues, by openly supporting a non-American.

At the IDB, in contrast, the candidate selected must win a double majority of votes. The candidate needs not only a majority of all weighted votes as at the World Bank, but also an absolute majority of the governors of the regional members (the 26 borrowing countries plus

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[6] See World Bank Office of the Corporate Secretary (2010).

[7] See for example the results of surveys sponsored by the Center for Global Development, Wheeler (2007, 2011).

[8] This wording was proposed in the final report of the Committee on IMF Governance Reform (2009).

Canada and the United States). The need for a majority of the regional members for all practical purposes guarantees that the winning candidate will be from one of the 26 borrowing countries.[9] At the same time, the need for a majority of the weighted votes guarantees that the winning candidate will be acceptable to the United States. The double majority vote provides for a kind of mutual containment of each other's influence for both borrowers, acting as a group, and the United States as the single largest creditor. The system also ensures that the United States controls the appointment of the executive vice president of the IDB, which must be approved by the board (with a weighted majority of votes, guaranteeing a veto of any candidate the United States does not want thus effectively ensuring the nominated candidate is an American). This is important because the EVP chairs the Loan Committee which reviews all loans before they go to the board.

The advantage of this process for the selection of the president (and other senior staff) is that it gives the borrowing countries the power to control the strategic agenda through the presidency, while ensuring the United States has an effective veto on lending and other decisions that could jeopardize the bank's financial soundness (which relies heavily on the paid-in and guaranteed capital of the United States and other creditors). The 50/50 split, the considerable "voice" of borrowers in the board, and the double majority vote for the presidency provide a balance between the essentially "yes" power of the borrowers in setting the agenda, and the "no" power of the United States, as the single largest creditor, in preventing abuse of the bank's financial clout. In this "system," a strong and effective president is one who can manage an ongoing negotiation between his major constituents among the borrowers, and his major financial backer.[10]

Financing cooperatives? Reconciling or not "legitimacy" and "effectiveness"

My argument is that the resulting balance makes the IDB better able to negotiate the relative shift in regional political and economic influence towards Brazil and other emerging market borrowers in the Latin America region compared to the United States – at least in comparison to the World Bank, where the challenge of engagement of China alone is far more complicated. The balance helps to reconcile what is otherwise at many of the international institutions a difficult tradeoff between their legitimacy as representative and open institutions and their long-run effectiveness as development institutions. The World Bank and the IDB are two of many inter-governmental clubs and associations that deal with economic and financial issues – the G-20, the United Nations, the International Monetary Fund, the World Trade Organization, the Financial Stability Board, the Basel Committee and many others – in which there is an almost inevitable tension between "legitimacy" (the extent to which they are seen as adequately representing the nations and people affected by their decisions) and their "effectiveness" (their ability as institutions to carry out their mission at reasonable cost). The United Nations General Assembly and UN agencies like the

[9] For discussion of the double majority system of voting for heads of the international institutions and citations to the larger literature, see Birdsall (2008).

[10] For an example of the role of the president in the 2010 decision on recapitalization of the IDB, see Morris (2014).

Food and Agriculture Organization, where every member nation has one vote and considerable voice (sometimes constituting a weak veto where consensus is the norm), are generally seen around the world as fully representative and legitimate but not particularly effective as implementing organizations.[11] Meanwhile, the G-20, a club of self-selected large economies, and the IMF and the World Bank, where the membership itself or the governance rules give larger and richer countries more votes and other forms of influence, are seen as effective (at least relative to the United Nations and many of its agencies) but not adequately representative and therefore less legitimate.[12]

In fact the argument can be made that legitimacy and effectiveness are complements, one supporting the other. The presence of borrowing member countries on the board and staff of the World Bank, even if limited compared to the presence of the United States and other creditors, certainly contributes to its effectiveness in responding to the credit and other needs of the borrowers.

The irony is that the World Bank was set up at Bretton Woods as a financing or credit cooperative[13] that would provide low-cost loans to European borrowers as well as developing countries, and European countries, borrowers at first, were well represented in that bank's original governance. The regional multilateral banks, including the IDB, were similarly set up in some respects as credit cooperatives, and that is still what distinguishes them from the bilateral aid agencies that also make transfers to developing countries. But the fundamental difference between borrowers and creditors early on became a difference between developed and developing economies at the World Bank and was extant at the origins of the regional banks in the 1950s and 1960s.

Governance and effectiveness at the World Bank

Has the lesser representation at the World Bank mattered for the institution's effectiveness? There is no simple way to define or measure the effectiveness of these institutions. In very general terms, their effectiveness is based on their ability to raise and efficiently allocate members' political and financial resources at positive rates of return to increase development and reduce poverty in their borrowing countries. Consider several indications of how limited developing country representation at the World Bank may have affected its effectiveness by that definition:

One has to do with raising new capital to meet additional needs of borrowers. In 2009 the World Bank increased its lending in response to the global financial crisis (Figure 1), reducing its capital reserves substantially. In 2010, the bank's leadership asked the member governments for the first capital increase since 1984.[14] The size of the capital increase was relatively small compared to the increase in the size of the borrowers' economies in the intervening period (Figure 2); the G24 (a group of finance ministers from developing

11 On the FAO, see Ramachandran (2013).

12 On the G-20, as an example, see Rueda-Sabater et al. (2009).

13 Birdsall (2006a).

14 World Bank Archives Online, see http://go.worldbank.org/NRD66T7ZD0 (accessed May 12, 2013).

countries) has since issued several papers arguing that the capital increase could have been much larger.[15] A likely constraint on the size of the capital increase came from the United States which did not want to see its capital and shares diluted but could manage only a limited request to the US Congress for the additional paid-in amounts.[16]

In contrast relatively large capital increases were agreed for the Inter-American and Asian Development Banks in 2010. At the same time the BRICS (Brazil, Russia, India, China and South Africa) are moving ahead in the creation of their own bank, though haltingly, apparently due both to the perceived need for greater borrowing for public infrastructure and other public services that the private sector will not fully finance, and in the interest of avoiding the delays and high transaction costs associated with borrowing from the multilateral banks.

A second indication that limited representation of borrowers in the governance may have undermined the effectiveness of the World Bank has to do with the concern that the advanced economies have dominated to a fault the ideological views of what works in growth and development at the World Bank. Critics of the so-called Washington Consensus reforms accuse the World Bank of pushing reforms single-mindedly in the 1990s in countries which in retrospect did not have in place the competitive environment and the requisite regulatory and other capacity to benefit from those reforms.[17] Some argue that the bank (and the IMF) did borrowers harm by using loan conditions to pressure them into capital market liberalization before their financial sectors were resilient enough, or into privatization programs that ended up enriching corrupt insiders.[18] An alternative critique is that dominance of the non-borrowers in the management and staffing of the bank (particularly economists who even when from developing countries have been mostly educated in the West) created a culture in which general, universal solutions to developing country problems were advocated without understanding the political and other local constraints and opportunities that effective support would require.[19]

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[15] For example, see the 2010 G24 communique at http://www.twnside.org.sg/title2/finance/2010/finance100402.htm (accessed February 24, 2014).

[16] The World Bank president, Robert Zoellick, put a recapitalization on the table with its members only after the regional banks had done so. Also, the relatively small request may have reflected lack of bipartisan consensus on the merits of a larger World Bank (Zoellick had been nominated by President Bush and was serving as president during the Obama Administration), and the reluctance of the Obama Administration to add to its requests before Congress a larger size capital increase for the World Bank.

[17] Woods and Narlikar (2001) describe the "new intrusiveness" of these organizations in the context of growing concern about the merits of their advice. The tendency to insist on universal recipes is one way to interpret Stiglitz's (2002) critique of the IMF's emphasis on fiscal austerity in East Asia during the financial crisis of 1997-98, and its emphasis (along with the U.S. Treasury and the World Bank) on rapid privatization in Russia in the early 1990s. The evidence that opening the capital account prematurely can exacerbate the vulnerability of emerging market economies to financial crises is another example.

[18] Stiglitz (2002).

[19] Rodrik (2005). See also Spence et al. (2008). The Spence Commission, set up by the World Bank and including distinguished economists and former finance officials of both developed and developing countries, agreed that there is no single recipe.

A third argument is that the World Bank, even as it was intrusive in pushing single solutions, was ineffective – for lack of local "ownership" – in helping countries in the implementation of solutions. In the case of major economic reforms, failures of implementation might have been rooted in the borrowers' gaming the system, i.e., signing up knowing conditionality would not be enforced; or in the bank and borrowers failing to anticipate political and other constraints; or because external conditionality tied to lending did not give insider reform supporters the leverage they expected. In the poorest countries of Africa, where the record of program implementation was weakest in the 1990s, the institutions often seemed powerless, politically or bureaucratically or both, to get results. In most settings, the political sustainability of an agreed program will be linked to the relative power and influence of the executive and the legislature, the positions of any relevant political parties, the interplay of various interest group pressures, and the likelihood that beneficiaries of a policy change (such as future exporters benefiting from a more open trade regime) will themselves have political influence. Yet programs supported by the World Bank implicitly assume a common interest of the lender and those groups in the country that can influence outcomes.[20]

The issue of ownership appears less important today (writing in 2013) than it did in the 1980s and 1990s heyday of the so-called Washington Consensus, in part because most developing countries, with their increasing integration into global capital and goods markets, hew more closely to sound macroeconomic policies in their immediate interests. However, the issue of ownership now haunts the tougher question of effective implementation of health and education programs, particularly in the low-income countries that still rely heavily on outside financing of those programs – in which donors and lenders from outside still prefer to finance inputs that are "planned" ex ante, and cannot easily predict or affect local bureaucratic, political and institutional or system realities that impinge on the effectiveness of those programs.[21]

[20]Acemoglu and Robinson (2012) refer to the apolitical stance of outside institutions as the "ignorance hypothesis," that is the assumption that developing countries don't know what to do, when in fact the obstacles to change have more to do with politics and the distribution of power. Similarly, Birdsall and James (1993) apply the key theory of public choice to social spending in developing countries, observe that prior to any particular allocation of resources there is a political equilibrium: if the advice or resources of the World Bank or any other external force leads to pressure to increase public spending on the education sector so as to put more poor children into school and make the distribution of public expenditures more progressive, there is likely to be a countervailing reaction to return to the initial equilibrium – for example via reductions in the overall tax burden on the wealthy, or an increase in spending within education on universities that benefit mostly higher-income households. Recent evidence suggests that in many low-income countries increases in spending on schooling have increased enrollment but not learning (Pritchett, 2013). Failure to understand the politics and the degree and nature of local ownership of a program can reduce the effectiveness of outside support.

[21] Increasing interest in cash on delivery and other results-based aid programs that pay for verified outcomes after the fact, instead of for planned inputs, reflects in part this ownership challenge. See Birdsall and Savedoff, 2010.

Governance and effectiveness at the IDB

Is there evidence that the IDB is more effective than it might have been as a result of its relatively greater borrower representation compared to the World Bank? Without a counterfactual, it's not possible to answer systematically. However several points suggest that possibility.

First, the ownership issue: The IDB is widely seen as closer to its borrowers. The regional borrowers for all practical purposes set the agenda in the IDB and it was their influence that led to a heavy emphasis from the IDB's founding on support for regional integration and for lending for social programs. (In 1961, the IDB began immediate lending for water and sanitation and for many years heavily supported higher education, whereas the World Bank did not.) The presidents of the IDB can, and have, used the institution as a platform for shaping new priorities at the regional level; early in the 1990s, President Iglesias brought together leaders of the judicial sector and defined with them a set of priorities for judicial reform and anti-corruption programs before these matters – now discussed under the rubric of "governance" – became prominent on the international development agenda. In the 1990s, borrowers had more control over the details of policy conditionality in IDB loans, to the point where World Bank staff complained about the easier terms the IDB allegedly permitted because of being "too close" to the borrowers and thus too willing to lend, independent of the merits of the program being financed.

Related to the ownership issue is the view that the IDB staff is more politically savvy than that of the World Bank, because the president comes from the region and because many of the key senior management positions on the lending side have traditionally been held by staff from the region. In general, staff from borrowing member countries at the senior level in the World Bank are less likely to be working in their own regions of origin, and less likely to speak the language of the borrowing country governments with which they are negotiating – though that has changed in the last decade. (Latin American countries are said to have resented the dominance of World Bank officials from Asia in work on their countries during the late 1980s and much of the 1990s, though not objecting to specific individuals.) Historically as well, World Bank staffing and promotions to senior levels have been highly meritocratic and largely apolitical; success for most staff required spending a considerable amount of time interacting with each other. At the IDB, many more senior officials have been appointed from outside the bureaucracy itself, on the basis of not only their technical capacity but also their political standing in their own countries. The IDB has been as a result more "politicized" than the meritocratic World Bank, with the possible benefit of being more politically attuned and client-oriented.

Second, as a regional bank, the IDB has been better able to build support for regional public goods into its programs than the World Bank has been able to support global public goods – an inherent advantage for a regional bank that is likely to matter more in an increasingly multi-polar global market system. As in the World Bank, the key lending product is the country-based loan, which cannot easily be made to finance a public good with benefits to many countries because of the problem of allocating borrowing costs across the benefiting countries. However, from its founding, its regional character has been part of the IDB's DNA. Over the years, the IDB put considerable technical work into regional trade agreements (including the still-born Free Trade Agreement of the Americas); has found ways to support cross-border infrastructure projects such as the electricity grid in Central America; and supported with special loans the strengthening of sub-regional banks including the Andean Development Bank (the CAF – Corporación Andina de Fomento) and the Central American Development Bank (CABEI, or BCIE, the Spanish acronym for Banco Centroamericano de Integración Económica). Much of this support has come from the very scarce concessional funds available.

Reflections on the future: The IDB's positioning for this century

My argument is that the governance arrangements at the IDB – votes, voice and selection of the president – are more conducive to that bank's retaining and strengthening its character as a credit cooperative, and more conducive to the IDB's ramping up its work on cross-border regional investments and issues than is the case for the World Bank to ramp up on cross-border global investments and issues.

But there is nothing inevitable about the future responses of the two banks. Over the last seven decades the World Bank has adapted well to changing development challenges. In 1960 it established its soft window for highly concessional lending to low-income countries. In the early 1980s it began lending for health, and in the mid-1980s created a new lending instrument to encourage policy reforms – initially referred to as the structural adjustment loan and now called a program and policy loan. In the 1990s it defined its fundamental goal as a world free of poverty. In 2012 it finalized another new lending instrument designed to transfer funds primarily on the basis of measured results as opposed to planned inputs – the Program-for-Results financing instrument. Over the years, the traditional Western donors have financed trust funds for the bank to administer, such as those that support the Consultative Group on International Agricultural Research and the Climate Investment Funds – almost to a fault to the extent that the bank's operational work is now heavily dependent on trust funds. Its private sector lending arm, the International Finance Corporation (IFC), gets higher scores for development effectiveness in terms of countries and sectors where engagement of publicly financed resources makes most sense, than the private sector window at the IDB.[22] And though the establishment of the Green Climate Fund suggests it will not take the leading strategic or policy role in the financing of climate mitigation and adaptation in developing countries, President Kim has been more specific and vocal on the nature of the crisis for the developing world (and the world as a whole) than his predecessors and has made dealing with the climate problem a strategic priority in its mainstream lending.

Moreover the World Bank is still *primus inter pares* among the development banks because of its global reach; its command over the full range of development sectors and issues; its notable capacity in data production and management and policy research; and the confidence of the major powers in its fiduciary and legal capacity.

[22] Perry (2009).

At the same time, however, the World Bank faces the risk of growing irrelevance for many of its major middle-income borrowers as their investment grades rise in line with their projected increases in per capita income. During much of the 2000s, net IBRD disbursements fell. They rose in response to the 2009-10 global financial crisis (see Figure 1), but over the last two decades, except in those crisis years, it has not generally managed to be counter-cyclical in its lending – reinforcing rather than offsetting changes in private capital flows.[23] In the last few years, its lending and activities in the low-income IDA countries has increased relative to its lending through its IBRD window (Table 4). If its role through the IBRD as a credit cooperative declines in the next several decades relative to that of IDA, it may become one of the world's most effective and efficient aid agencies,[24] particularly for conflict-ridden and other fragile economies. But it will have lost its character as a setting for cooperation and for shaping strategic priorities at the global level to tackle the challenges to sustained growth and development posed by climate change, illegal cross-border activity, global financial market failures, health pandemics and so on – and on exploiting the opportunities a globally integrated economy provides for the world's bottom half of the income distribution.

What about the IDB? It also faces challenges, and it is not inevitable that the IDB will retain its position as the leading development bank for the Latin America and Caribbean region in terms of lending or the setting and support of regional economic and social priorities.

But, compared to the World Bank, it has some advantages in that role – as a credit cooperative and as a leader in shaping regional priorities and responses. An inherent one is its status as a regional bank, in which the major borrowers play a relatively larger role than they can in the World Bank, including relative to the United States. The borrowers' greater relative role is locked in now in the form of the 50/50 split and their control as a group of the choice of the president. It has only five small economies that are dependent on its soft window (the Fund for Special Operations, or FSO), so its role as a traditional "aid agency" as opposed to a bank is relatively small. A telling sign of the "ownership" of the bank by the borrowers discussed above is that in the negotiations of the recent general capital increase, several of its largest borrowers, including Brazil, were reportedly interested and willing to put more capital into the bank. (The United States was unwilling to see its own capital share further diluted and/or the US Treasury was unwilling to ask Congress for the additional paid-in capital it would have needed to put to retain its current share.) That is not surprising in that total lending by the IDB in the Latin America and Caribbean region now exceeds lending by the World Bank in that region.[25] The IDB has made notable and prominent contributions to intellectual leadership on development issues in its region, sometimes contesting successfully the positions of the IMF and the World Bank.[26] Among its

[23] ibid.

[24] The IDA window of the World Bank scores among the top ten of the 31 largest bilateral and multilateral aid agencies on three of the four dimensions of aid quality measured in the 2012 QuODA report (Birdsall et al., 2012).

[25] In fiscal year 2011, the World Bank Group through IDA and IBRD was lending a total of US$ 9.6 billion in Latin America and the Caribbean (World Bank lending includes guarantees and guarantee facilities). In the same year, the IDB approved loans and guarantees totaling $10.4 billion.

[26] Center for Global Development and Latin American Shadow Financial Regulatory Committee (2006).

contributions were its work on banking crises in the region (including "sudden stops" and the "original sin" of local currencies that were not tradable in international markets[27]); its early and constant support in Mexico for the piloting and testing of conditional cash transfers;[28] its work on regional trade issues mentioned above; and its report on inequality published in 1998,[29] which preceded the comparable 2006 World Development Report of the World Bank on that subject by almost a decade.

The IDB has its own rivals within the region, most notably the Andean Development Corporation (the CAF, using the Spanish-based acronym). In a comparison analogous about the IDB versus the World Bank, the CAF is said to be more agile and more responsive to its borrowers than the IDB. But the CAF is also more costly for its borrowers because it does not have the IDB's benefit of guaranteed backing for its borrowing by its high-income members. A much higher portion of the CAF capital is therefore paid-in (Table 3).

Table 3 also lists the capital and the paid-in portion of capital at the European Investment Bank, which is a possible long-run model for the Latin America and Caribbean region, assuming continuing convergence of per capita income between the current non-borrowing and borrowing members of the IDB (Table 5).

Some of the potential advantages for the IDB looking forward are built into its nature as a development bank. Some are also structural – directly associated to its current balanced governance arrangement, a key argument of this paper. Some are fortuitous; the United States was more willing in the 1990s to dilute its capital share in a region where almost all the borrowers had become democracies, and where there was a broad consensus on the relative roles of the market and the state, with the private sector as the engine of growth and the state as enabler of growth by supporting a level playing field and the rule of law. Some are unsurprising: the Americas as a region has a geographic integrity and a common cultural and religious history; and the borrowers at the IDB are "closer" to the major creditors (the United States and Canada) in the region in income, fertility levels, the status of women, education, health and other indicators.

The question is whether through leadership and luck in the next several decades, the IDB will be able to exploit these advantages. It will be a better future for the people of the Americas if it does.

[27] Calvo (1998); Eichengreen et al. (2005).

[28] Behrman and Hoddinott (2005).

[29] Inter-American Development Bank (1998/99).

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Table 1: Governance Structure of International Financial Institutions (FY 2012)

	Voting shares (percent)			Directors (seats)			President
	US	Other non-borrowers	Developing country borrowers	US	Other non-borrowers	Developing country borrowers	
IMF (a)	16.5	38.7 (b)	44.8 (b)	1	12	11	non-borrower
IBRD	15.11	37.7 (c)	47.19 (c)	1	13	11	non-borrower
IDA	10.71	43.24	46.05	"	"	"	"
IDB	30.01	19.98	50.02	1	4	9	borrower
AsDB	12.78	45.63	41.59	1	5	6	non-borrower
EBRD	10.16	77.37	12.48	1	18	4	non-borrower
AfDB	6.59	33.20	60.21	1	5	12	borrower

Notes: (a) Voting shares reflect quota increases agreed to at the conclusion of the 14th General Review of Quotas in November 2010. As of July 31, 2013, the quota and governance reform was not yet in effect. See also tables at http://www.imf.org/external/np/sec/pr/2011/pdfs/quota_tbl.pdf (accessed February 25, 2014).

(b) Non-borrowers are all "advanced economies" according to the IMF country classification (August 2013).

(c) Non-borrowers are "high income countries" according to the World Bank country classification (August 2013).

Sources: AfDB (2013), AsDB (2013), EBRD (2013), IDB (2013), IMF (2012), World Bank (2012).

Table 2: Recent MDB Capital Increases

		IBRD	AsDB	AfDB	IDB	EBRD
Before	Paid-in	11.5	3.9	3.5	4.3	EUR 5
	Callable	178.5	51.1	30.5	96.7	EUR 15
	Total	190.0	55.0	34.0	101.0	EUR 20
	Paid-in %	6.05%	7.09%	10.29%	4.26%	25.0%
Capital Increase	Paid-in	5.1	3.4	4.1	1.7	0.0
	Callable	81.1	106.6	63.9	68.3	EUR 9
	Total	86.2	110.0	68.0	70.0	EUR 9
	Paid-in %	5.92%	3.09%	6.03%	2.43%	0%
After*	Paid-in	16.6	7.3	7.6	6.0	EUR 6**
	Callable	259.6	157.7	94.4	165.0	EUR 24
	Total	276.2	165.0	102.0	171.0	EUR 30
	Paid-in %	6.01%	4.42%	7.45%	3.51%	20.0%

Notes: Figures in USD billions, except for EBRD;

* denotes authorized capital, not subscribed capital;

** includes EUR 1bn transferred from EBRD's reserves.

Table 3: Capital Structure of Corporación Andina de Fomento (CAF) and European Investment Bank (EIB)

		CAF	EIB
Current	Paid-in	3.23	15.01
	Callable	0.74	285.95
	Total	3.97	300.96
	Paid-in share	81.36%	4.99%
	Credit rating	A1	Aaa

Notes: Figures in billion USD. All information as of December 31, 2011.
Sources: European Investment Bank (2013), Corporación Andina de Fomento (2011).

Table 4: World Bank Net Disbursements by Loan Window

	IBRD	IDA
FY06	-1,910	7,816
FY07	-6,494	7,178
FY08	-2,148	7,070
FY09	8,481	7,124
FY10	17,230	9,111
FY11	7,746	7,540
FY12	7,406	6,683
FY13	6,112	6,876

Notes: All figures in constant 2010 US$, million. Deflated with US CPI-Urban.
Source: World Bank, US Bureau of Labor Statistics.

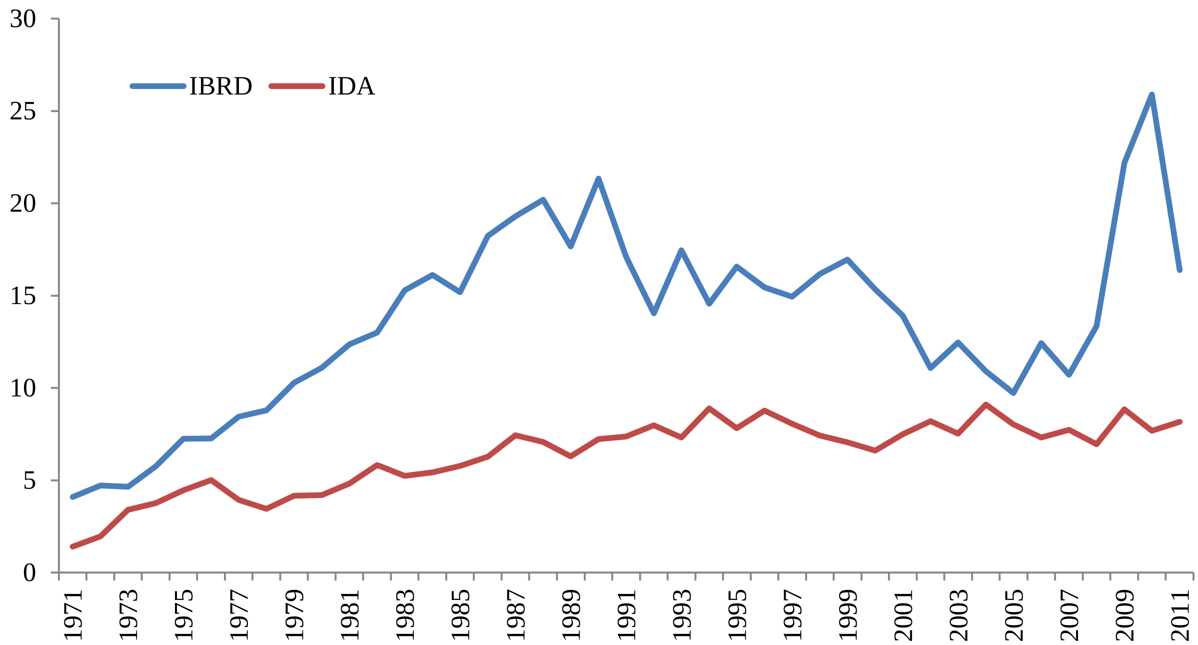
Table 5: GDP, Population and GDP per capita of Borrowing and Non-Borrowing Members, by Regional Development Bank (2010)

	Top non-borrowing member(s)					Sum of regional borrowing members (a)		
	Country	Voting share (percent)	Population (m)	GDP (bn USD)	GDP/capita (USD)	Population (m)	GDP (bn USD)	GDP/capita (b) (USD)
AsDB	Japan	15.61	128	5,495	43,118	3,620	9,913	3,772
AfDB (c)	Germany	4.10	82	3,284	40,164	1,017	1,647	3,545
	France	3.76	65	2,548	39,186	1,017	1,647	3,545
IDB	United States	30.01	309	14,420	46,616	556	4,718	9,624

Notes: (a) Borrowing members are all low- and middle-income member economies, according to the World Bank country classification (August 2013).
(b) GDP per capita is weighted by country population.
(c) The biggest non-borrowing shareholders of the African Development Bank were the United States, Japan, Germany, Canada, and France (as of December 2010).
Sources: AfDB (2013), AsDB (2013), IDB (2013).

Figure 1: World Bank Group Gross Disbursements over Time

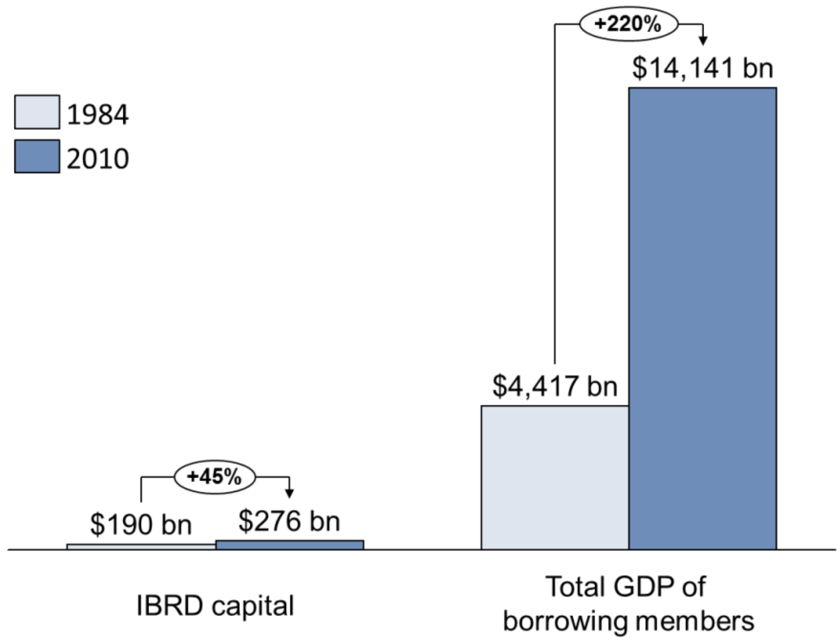
Disbursements (constant 2010 US$, billion)



Notes: Disbursements are drawings by the borrower on loan commitments during the year specified. All figures in constant 2010 US$, million. Deflated with US CPI-Urban.

Source: World Bank WDI, US Bureau of Labor Statistics.

Figure 2: Change in IBRD Capital and IBRD Borrowing Members' Total GDP



Notes: Borrowing members are all low- and middle-income member countries in 1984 and in 2010, according to the World Bank classification in that year. GDP figures in constant 2010 US$, deflated with US CPI-Urban.

Source: World Bank WDI, US Bureau of Labor Statistics.