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Compassionate Conservatism Confronts Global Poverty

On March 22, 2002, President George W. Bush announced his intention to request an increase of $5 billion per year over current foreign assistance levels of $12.5 billion through the creation of a bilateral development fund, the Millennium Challenge Account (MCA). The MCA presents an enticing opportunity to transform U.S. development policy. Because the MCA is being crafted at a time when national security has returned to the forefront of the nation's consciousness, however, there is an acute risk that the MCA will instead further add to the confusion of overlapping U.S. programs and criteria for developing nations. In announcing the program, Bush stated explicitly, "We fight against poverty because hope is an answer to terror."[1]

To implement the program, the administration has recommended the creation of an independent agency, the Millennium Challenge Corporation (MCC), to allocate the new funding based on objective selection criteria measuring a nation's commitment to "governing justly, investing in people, and encouraging economic freedom."[2] Yet, numerous aspects of the MCA's internal design and operation that will prove crucial to its ability to meet these goals still have to be developed. On what kinds of programs will the MCA focus? Will the established methodology to select countries yield the types of recipients intended, or will geopolitical imperatives influence the allocation?

Moreover, the MCA should not be designed in a vacuum, or it will fall prey to the tension between foreign policy and development goals that chronically afflicts U.S. foreign assistance programs. The president's deci-

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sion to establish a new agency to administer the MCA was a clear vote to design around the 7,000-strong U.S. Agency for International Development (USAID), established in 1961 with the mission of "promoting sustainable development," rather than confront the messy challenge of reforming it. Nevertheless, a successful transformation of U.S. development policy requires a concrete plan for how the efforts of the two organizations can complement each other.

Congress must also be a committed partner if the MCA is to break new ground on development assistance. The unprecedented flexibility sought for the MCA will only be possible if the design contains adequate self-executing safeguards and is presented in the context of a coherent foreign assistance strategy.

The proposed expansion of U.S. assistance to combat global poverty in nations committed to reform is ambitious and exciting. There is a risk, however, that this administration-led initiative will fall short of expectations unless many critical, remaining decisions are made, and soon, so that MCA funding does not follow the fruitless path of much of U.S. aid during the Cold War; so that the MCA and USAID can avoid bureaucratic redundancies that lead to waste; and so that the MCA can enjoy the kind of congressional and national support it will need to succeed—and positively transform U.S. foreign assistance efforts at large.

Potential Promise and Pitfalls

At best, the MCA could transform U.S. policy toward the poorest countries over time—driving greater coherence among U.S. trade, aid, and investment policies and helping to rationalize existing programs. With clear criteria and substantial sums of money made available on enticing terms, the MCA could create incentives for governments to improve economic policies and governance while helping strong performers sustain growth and improve investment climates. By establishing a record of success, the MCA could earn both the trust of Congress and a measure of independence from political meddling by the executive branch, freeing it from burdensome restrictions and procurement requirements faced by other agencies. A successful MCA could also have salutary ripple effects on other U.S. aid programs by strengthening public support, clarifying missions, and leading to greater overall coherence. Such a best-case scenario could strengthen USAID, helping it to focus more clearly on challenges the MCA does not address: humanitarian crises, transition in postconflict countries, and social investments in weaker performing states.

Unfortunately, darker scenarios are at least as plausible, wherein the MCA becomes one more pot of money among a morass of overlapping U.S. programs and conditions. At one extreme, by maintaining too high a degree of purity, the MCA might remain beyond the reach of most poor nations. It would thus become the more marginal player in development assistance rather than the key player, relevant only for the few stellar performers with substantial local capacity to formulate and implement proposals, while USAID would remain the main source of U.S. funding for the far more numerous, less capable countries.

At the other extreme, the MCA could become the preferred fund not only for the best performers but also for geopolitically salient countries. This outcome could very well emerge if the increased demand for assistance associated with security imperatives and the rapidly deteriorating budgetary environment conspire to undermine the MCA's purity. If this scenario evolves, the lines between the MCA and other forms of assistance would blur, and Congress might feel compelled to constrain the MCA as it currently constrains existing assistance programs.

Development policy and foreign policy have historically pulled in different directions.

In fact, the administration's November 2002 decision to expand the MCA pool of eligible countries to include not just the poorest but also lower-middle–income countries moved in precisely this direction, taking development advocates completely by surprise. With this change, the eligibility pool encompasses nations already among the largest beneficiaries of politically directed U.S. assistance but which do not qualify for concessional lending from the World Bank, such as Russia, Jordan, Egypt, Colombia, Peru, and South Africa. In fiscal year 2002, these six nations received $1.25 billion in U.S. economic assistance—one-fifth of all foreign economic assistance for nondisaster programs.

The deteriorating budget outlook raises the stakes. In the words of the director of the Office of Management and Budget, Mitch Daniels, "Unexpected new defense and homeland security spending is needed to protect America from new threats. Given these two developments, it is absolutely essential that we set aside business as usual and keep tight control over all other spending." Within the context of the overall discretionary spending increase cap of four percent, and in light of the increased demand for security and defense spending, finding room in the budget for the MCA and the additional $1 billion in HIV/AIDS funding pushed by Congress and promised by President Bush has proven difficult. In fact, the FY 2004 request for the MCA totals just $1.3 billion—20 percent less than the illustrative funding level of $1.66 billion suggested by a White House fact sheet released after the MCA proposal.[3]

U.S. Foreign Assistance: A Servant to Two Masters

To shape the success of the MCA requires a clear understanding of why previous programs have failed. More often than not, development policy and foreign policy have pulled U.S. foreign assistance programs in two different directions. Too often, U.S. economic assistance is equated with development assistance, contributing greatly to aid's discredit. The history of U.S. assistance is littered with tales of corrupt foreign officials using aid to line their own pockets, support military buildups, and pursue vanity projects. It is no wonder that few studies show clear correlations between aid flows and growth.

It makes little sense, however, to measure the return on investment in economic terms when aid dollars were allocated according to geopolitical criteria in the first place. In some cases, aid has yielded the desired geopolitical outcomes while failing to yield economic gains; in other cases, it has failed on both fronts. Most examples of aid lost to corruption, waste, or diversion—as was the case in Zaire, Liberia, Sudan, and Somalia—involved aid allocated according to Cold War logic. The billions of aid dollars poured into Egypt since the Camp David peace accords may have achieved their goals even though they have been criticized for failing to produce durable economic or political modernization. On the other hand, even politically motivated assistance can yield impressive economic dividends when recipients are committed to reform and have sound economic policies, as happened in Taiwan and South Korea.

It is important to distinguish between the principles that guide the allocation of U.S. aid among countries and the purposes for which aid is spent in those countries. Strictly speaking, for assistance to have the greatest impact on a nation's development, funds not only must be spent on economic development but also must be allocated on the basis of development worthiness. The fact of the matter is that the majority of what is considered "economic assistance" in the U.S. budget is actually directed to countries based on political considerations, even though the money itself is used for economic purposes. Only about a third of existing FY 2002 U.S. bilateral economic assistance (and an even smaller portion of overall aid) is allocated among countries based on developmental priority, and in contrast to the MCA, much of this aid is not based on performance but rather on assessed needs as well as on the political and economic objectives of the United States.

To make this distinction clearly, table 1 shows a taxonomy of various interests and objectives that U.S. assistance intends to promote.[4] (This taxonomy implicitly assumes a set of disqualifying political criteria, such as

Table 1: Foreign Policy Goals of U.S. Assistance

Type of Beneficiary	Objectives/Interests of U.S. Foreign Policy	Examples
Strategic Partner	• To maintain goodwill or provide a political reward deemed vital to U.S. interests.	Egypt
Quid Pro Quo	• To secure cooperation on a particular activity (e.g., counternarcotics and counterterrorism measures). • Mainly targeted at cooperative activity but may encompass development assistance.	Colombia
Regional Linchpin	• To help maintain the economic stability of a country that serves as a critical regional anchor whose instability could have ripple effects throughout the region. • Targeted at development.	South Africa
Failing/Postconflict	• To avoid a vortex of instability that poses risks in the region or more generally through external intervention.	Afghanistan
Salient, Stable	• To maintain the support and goodwill in multilateral arenas of countries where the United States has moderate to negligible direct interests in their economic development.	Senegal
Afflicted with Humanitarian Crises	• To address humanitarian emergencies, regardless of the development worthiness of the affected countries.	Hurricane Mitch

demonstrating inadequate respect for human rights or engaging in activities contrary to U.S. or international security interests such as proliferation.)

In principle, pure development assistance should be allocated to the investments with the highest potential social value, which generally reflects a combination of the extent of need and the local policy environment. Typically, U.S. development assistance is conditioned on the beneficiary's policy performance and on per capita income levels, with the poorest countries receiving the most generous assistance. Unlike the existing USAID Development Assistance and Child Survival and Health funds, which are allocated to countries whose development needs are most compelling, the MCA would attempt to isolate the highest potential investments by targeting only the best performing poor countries.

The figures in table 2 show that less than one-third of the administration's FY 2003–requested U.S. foreign assistance budget of roughly $18 billion[5] is actually devoted to development assistance, in the strict sense that both the

Table 2: U.S. Foreign Assistance and Development

TYPE OF ASSISTANCE	FY 2003 REQUEST (IN $ BILLIONS)	% OF TOTAL	LEAD AGENCY
TOTAL	18.7	100	
DEVELOPMENT AID	5.8	31.0	
Bilateral Development Assistance[A]	2.8	15.0	USAID
Food Aid for Development[B]	0.6		State, USAID
Multilateral Development Programs	1.4		Treasury, State
U.S. Export, Investment Programs; Peace Corps and Development Foundations	1.0		Independent agencies
POLITICALLY ALLOCATED ECONOMIC ASSISTANCE	5.1	27.3	
Economic Support Funds (ESF)	2.5		State, USAID
Assistance for Eastern Europe & the Baltic States (SEED)	0.5		State, USAID
Assistance for the Independent States of the Former Soviet Union (FSA)	0.8		State, USAID
International Narcotics Control and Law Enforcement (INCLE)[C]	0.9		State
Nonproliferation, Antiterrorism, Demining, and Related Programs (NADR)[C]	0.4		State
HUMANITARIAN ASSISTANCE	1.6	8.6	
Migration and Refugee Assistance (MRA)	0.7		State
Disaster Assistance	0.3		USAID
Emergency Food Aid (Title II, P.L. 480)	0.6		USAID
SECURITY ASSISTANCE	5.0	26.7	
Foreign Military Finance (FMF)	4.1		Defense, State
International Military Education and Training (IMET)	0.08		Defense, State
Peacekeeping Operations and International Peacekeeping	0.8		Defense, State
INTERNATIONAL ORGANIZATIONS AND PROGRAMS[D]	1.2	6.4	State

Notes

A Although the majority of these funds are bilateral, this category includes some funds for regional or global programs as well as contributions to some international agencies.

B The table includes Public Law 480, Title II (nonemergency and humanitarian assistance) food aid. Roughly another $0.6 billion in food aid should be available through Public Law 480, Title I (concessional sales) programs and Section 416(b) surplus commodity programs. Because these are budgeted through and administered by the Department of Agriculture, they are not reflected here.

C In fact, less than half of the counternarcotics assistance is devoted to development. The remainder, which is devoted to interdiction, may fit better conceptually in the security assistance category; this is also the case for the NADR spending.

D Includes both assessed and voluntary contributions.

eligibility criteria and the programmatic impact focus on development. Another quarter of the foreign assistance budget is directed toward economic ends but is allocated according to political criteria, and the remainder is provided for security and humanitarian assistance and contributions to international organizations. Of the $5.9 billion in development assistance, $2.7 billion, or slightly less than half, is for bilateral development assistance; and the remaining development assistance is for multilateral organizations, food aid, the Peace Corps, and U.S. export and investment programs. Two striking comparisons emerge from these numbers: The proposed $5 billion magnitude of the MCA is nearly double the size of existing U.S. bilateral development assistance programs, but the United States currently spends very little on bilateral development assistance—only about half the level of bilateral economic aid for political purposes. The president's budget request for FY 2004 would increase the share of the foreign assistance budget devoted to bilateral development aid by half—from 15.0 percent to 22.6 percent—reflecting the new funding for the MCA and the Global AIDS Initiative.

It makes little sense to measure economic returns when aid was allocated geopolitically.

In contrast with the majority of U.S. foreign assistance, the MCA's allocation criteria, based solely on economic performance and governance, would be the closest to a development purist's blueprint for aid that the United States has ever attempted. In many respects, the MCA is precisely the sort of fund that development advocates had hoped would emerge as the Cold War wound down. Instead, in the absence of the aid imperative associated with the threat of communism, development assistance declined through much of the 1990s until initiatives on debt relief and HIV/AIDS were funded at the end of the decade. Paradoxically, the MCA, which would be the largest single increase in pure development assistance, was announced only a few months after the tragedy of September 11, 2001.

Security experts were puzzled by the proposal to sharply increase pure development assistance at a moment of greatly increased need for political funding to reward allies in the antiterrorism coalition, shore up "front-line" states, and stabilize failed states. In fact, few such countries could meet economic performance and governance tests, even though Bush used this rationale when he announced the MCA, declaring, "We also work for prosperity and opportunity because they help defeat terror. … When governments fail to meet the most basic needs of their people, these failed states can become havens for terror."[6]

Through 2003, there had been an enormous increase in terrorism-related assistance—on the order of $3.3 billion in FY 2002,[7] but development assistance has remained flat, despite compelling needs on infectious disease and education. With requirements for security-related assistance increasing and with an overall budget crunch, the risk is high that MCA funding could be diverted to strategically important countries or that USAID funding for critical health and education programs in weaker but just as needy nations could be squeezed.

Critical Design Elements

Whether or not the MCA is transformational for U.S. development policy hinges in great part on its design and operation. As of the end of 2002, the Bush administration had developed details on three elements of its design. First, the MCA would be administered by a new government corporation—the MCC—overseen by a board composed of cabinet-level officials, and chaired by the secretary of state. Second, the MCC would have a staff of roughly 100 on limited-term appointments. Third, extraordinarily detailed information has been provided on performance indicators—the criteria for selecting countries. In contrast, the administration has made no statement on several critical operational questions:

- What types of programs would the MCA fund?
- Would the MCA support expenditures not currently funded by USAID, such as budget support and sectoral support, as well as capital projects and recurrent costs?
- How would monitoring and evaluation be performed?
- What is the division of responsibilities between the MCA and other U.S. agencies, such as USAID and the Overseas Private Investment Corporation (OPIC)?

The theory animating the MCA appears akin to a take-off model, according to which foreign assistance plays a catalytic role at an initial, critical stage, helping a country with good policies to attract investment and trade, thereby graduating after a relatively short time. In the president's words, "Countries that live by these three broad standards—ruling justly, investing in their people, and encouraging economic freedom—will receive more aid from America. And, more importantly, over time, they will really no longer need it, because nations with sound laws and policies will attract more foreign investment."[8]

Most development experts would expect this process to take decades rather than the several-year horizon that the MCA architects have suggested. Nonetheless, many outside observers support the emphasis on strong policy environments and hope that the MCA's focus on the best performers will produce concrete results and thereby win political support from Congress and the public over time.

Although research elsewhere provides more detailed recommendations for the MCA design,[9] the ultimate success or failure of the MCA initiative largely hinges on what decisions are made on a few critical issues.

Selection Criteria

The administration has highlighted the selection criteria as the defining aspect of the MCA. The decision to fund only the best performers not only intends to create good incentives for reform but also is the underlying rationale to provide both the beneficiaries and administering agency a greater sense of ownership as well as more flexibility in the use of funds. Getting the selection criteria right is, therefore, absolutely critical. Although compelling in theory, however, the data are unlikely to be up to the task in practice, creating greater scope for discretion than might be hoped.

Countries must meet per capita income criteria, which rise progressively over the first three years. In the first year, only countries eligible to borrow from the International Development Association (IDA) and having annual per capita incomes less than $1,435 (the historical IDA threshold) will be considered. In the second year, the pool will expand to include all countries with annual per capita incomes less than $1,435, regardless of IDA eligibility. In the third year, all countries with per capita incomes up to $2,975 a year—the World Bank threshold for lower-middle–income countries—will be included.

Selection will be based on scores on 16 data indicators, grouped in three broad areas: (1) governing justly (six indicators), (2) investing in people (four indicators), and (3) promoting economic freedom (six indicators). To qualify for assistance, a country must score above the median overall on at least half of the indicators in each area and specifically on the "controlling corruption" indicator. Countries with annual per capita incomes less than $1,435 will be scored against the median in their group while those with incomes between $1,435 and $2,975, when they become eligible in the third year and beyond, will be evaluated separately.

On the surface, this approach is as analytical and objective as one is likely to find in the realm of policy. The method is appealing insofar as it lays out a transparent methodology, against which the actual results can be compared to check for fairness and objectivity. In principle, the data should measure those variables that empirical research has shown to be the best predictor of poverty reduction and growth. In practice, the Bush administration's indicators—emphasizing responsible fiscal and monetary management, investments in basic health and education, and accountable and efficient governance—conform to this approach. Most economists would also support the inclusion of efficient levels of regulation and economic openness, although the role of trade openness in contributing to growth has been contested.[10] Finally, including indicators measuring political rights and civil liberties is important for winning U.S. domestic political support.

The risk is high that MCA funding could be diverted to strategically important countries.

In effect, however, this approach produces some surprising outcomes, as evidenced by a dry run undertaken by Steve Radelet.[11] The most notable result is that both China and Egypt would qualify quite comfortably under this methodology, despite China's severe human rights deficiencies and Egypt's history of wasting vast quantities of aid.

There are several reasons why this approach risks yielding results that do not comport with common sense. First, the quality of the data varies enormously. Indicators for a country's policies on health and education can be measured with numerical precision, as is the case for fiscal and monetary performance in general; but indicators for trade openness, the regulatory climate, and most of the governance data are surveys or composites of a variety of statistics, which are measured with a high degree of error.[12] Further, even though the administration's proposed inclusion of data on the number of days to open a business has intuitive appeal, the data series is in fact new, and its contribution to growth is yet unproven.

Second, the methodology tends to magnify rather than correct data deficiencies. Because countries are required to score above the median on half the indicators in each category, and the categories contain several indicators that are highly correlated, some countries achieve eligibility despite what might seem a disqualifying weakness in the remaining subset of indicators. Thus, Egypt, which has a terrible record on overregulation and trade protection, nonetheless gets a passing score on economic freedom on the basis of the macroeconomic indicators alone, which are likely to be interrelated. China qualifies on governing justly despite the country's terrible human rights record because China scores above the median on the half of the indicators relating to governance and corruption, which are highly correlated, rendering the remaining indicators that measure political and civil rights in the governing justly area irrelevant. Finally, the MCA's emphasis on virtue relative to need is starkly evident in that eligible countries are home to only 12.8 percent of the population of sub-Saharan Africa—the poorest region in the world.

Political Discretion or Political Bias?

Problems inherent in the selection methodology, combined with significant lags and incomplete coverage in the data, are bound to leave a large role for subjective judgment. This in itself is not surprising and need not bias the selection process, but in allowing more room for discretion, such problems could contribute to greater geopolitical bias, given the administration's decisions to designate the secretary of state as the lead on the MCC's board of directors and to expand the eligibility pool to include politically salient countries in the third year of operation.

In particular, although the effect that including lower-middle–income countries in the MCA would have on poverty reduction and growth remains open for debate, one cannot deny that this approach is essential for bringing strategically significant countries such as Jordan, Egypt, and South Africa into the tent. Table 3 shows the amount of foreign economic assistance that currently goes to countries likely to qualify for the MCA in the first three years. The expansion of eligible recipients, associated with the inclusion of the lower-middle–income countries, considerably expands the potential for overlap between the MCA and funding under existing assistance programs, especially those allocated according to political considerations. Lower-middle–income countries that could qualify for the MCA account for 34 percent of current Economic Support Fund aid and 24 percent of development assistance for counternarcotics programs. Overall, these countries account for almost $1 billion in current aid—nearly double the assistance received by likely MCA countries with lower per capita incomes.

With the inclusion of the lower-middle–income group, countries receiving one-quarter of current U.S. economic assistance would be eligible for the MCA. By themselves, the low-income countries account for 8 percent of existing assistance—or $0.5 billion—which is only one-tenth of promised MCA funding levels. A central issue, therefore, is whether the MCA funding would constitute additional funding for these countries, free up existing assistance to be allocated elsewhere, or effectively substitute for this assistance eventually.

Overlap with Trade Preferences and Debt Relief

For U.S. development policy to achieve maximum effectiveness, it should develop an integrated approach toward meritorious countries, combining aid with the powerful tools of trade, investment cooperation, and debt relief. Thus, an important question is whether the incentives associated with MCA eligibility are closely aligned with eligibility for complementary U.S. trade and debt relief programs for developing countries. The overlap turns out to be strikingly low.[13] The Heavily Indebted Poor Countries (HIPC) program targets those countries whose debt burdens are deemed an impediment to poverty reduction and growth. HIPC includes fairly stringent selection criteria on income and the degree of a country's indebtedness and openness. The program further requires that a significant portion of the proceeds be devoted to the same types of social investments included in the MCA selection criteria. Remarkably, only 7 of the 27 countries that have been approved for HIPC are likely to be eligible for the MCA, while the remaining 16 countries likely to qualify for the MCA are not HIPC eligible.

Table 3: Current U.S. Economic Assistance for Likely MCA Countries (FY 2003 Request, $ Millions)

MCA-Eligible Countries	Development Assistance	ESF	SEED/ FSA	INCLE Development	Total
Total: Low-income countries (less than $1,435)	326	64	115	42	547
Percent of Total	12	3	9	14	8
Total: Lower-middle–income countries ($1,435–2,975)	121	775	28	69	993
Percent of Total	4	34	2	24	15
Total: MCA-eligible countries	447	839	143	111	1540
Percent of Total	16	37	11	38	23
Total: All countries	**2740**	**2290**	**1250**	**291**	**6571**

Sources: The list of likely eligible countries is based on Steve Radelet, "Qualifying for the Millennium Challenge Account," Center for Global Development, December 13, 2002, app., www.cgdev.org/nv/Choosing_MCA_Countries.pdf (accessed January 22, 2003). Estimates of foreign assistance are from the U.S. Department of State "FY 2003 International Affairs (Function 150) Budget Request, Account Tables," February 4, 2002, www.state.gov/documents/organization/9194.pdf (accessed January 22, 2003).

The United States has several trade preference programs for developing nations; these programs provide favorable access to the U.S. market through zero tariffs (and quota relief in some textile and apparel areas). The African Growth and Opportunity Act (AGOA), Caribbean Basin Initiative (CBI), and Andean Trade Preference Act (ATPA) programs provide the most generous terms in their respective regions. The regional programs have selection criteria on per capita income, corruption, and trade openness—similar to the MCA's criteria—and include additional conditions on workers' rights. The AGOA program also requires progress on the same types of social investments in basic health and primary education that the MCA emphasizes. Still, the overlap is slim. So far, 38 countries have been approved for AGOA benefits; of these, only six are likely to qualify for the MCA initially, and one other country that meets the MCA selection criteria has not been approved for AGOA benefits. There is a similar mismatch with the CBI program: only 3 of the 24 CBI countries are likely to meet MCA criteria initially. For the ATPA program, two of the four eligible countries are likely to meet MCA criteria.

The MCA is designed to provide assistance in a catalytic role at an initial, critical stage.

Country Ownership and Accountability

A core tenet of the MCA proposal is the recipient country's sense of ownership of the funded programs and accountability for achieving results. This approach accords with a growing international consensus that development investments perform better when they are formulated by the beneficiary government through a transparent and participatory process as part of an integrated development strategy. Indeed, the notional MCA process would appear to push this approach further than other bilateral aid organizations do. Notionally, governments that meet the selection criteria would submit funding proposals of their design, rather than reserve the responsibility for formulating proposals in the aid agency, as is currently the practice with USAID. To ensure accountability, a rigorous monitoring and evaluation process would accompany the greater flexibility accorded to beneficiaries.

The administration's rhetoric surrounding the MCA suggests the foreign aid analogy of the domestic welfare-to-work initiative, but those familiar with the messy realities of development in the field wonder whether the program will look so neat in practice. Will the limited capacity of governments in poor nations to formulate and implement acceptable grant proposals ultimately push the MCA to revert back to the current USAID model, whereby the U.S. government relies on an army of U.S. consultants and nongovernmental organizations to design the project and submit proposals? Will the complicated contracting procedures required by Congress necessitate a much greater field presence than envisaged?

With a staff of only 100, can the MCC effectively administer $5 billion in grants a year, including a rigorous, initial proposal review process and an even more rigorous monitoring and evaluation process? As table 4 (assistance-to-staff ratios for a number of bilateral aid agencies) shows, the administration's design implies a disbursement rate of $50 million per staff member annually, which is an order of magnitude greater than that for other aid agencies.

Program Areas

Finally, the administration has provided little information about the MCA's programmatic emphasis. What programs will be funded?

Presumably, certain program areas would be designated for MCA consideration at the outset. Clearly, there is broad support in the administration and Congress as well as at the international level for social investments in areas such as basic health, primary education, and sanitation. Environmental and energy programs, however, do not appear to be priorities for the administration, despite support in Congress and the emphasis on sustainable development in the Millennium Development Goals adopted at the United Nations in September 2000 for achievement by 2015.[14] Conversely, various administration officials have emphasized support for private-sector development and have focused on infrastructure investment even though poor performance led USAID to abandon the infrastructure business long ago.

A second question is whether a particular amount would be set aside for each program area or if there would be other mechanisms to steer MCA funds toward investments the United States considers high priorities within a beneficiary country. Clearly, it would be more in keeping with the beneficiary-driven approach for MCA funding to be allocated strictly on the strength of beneficiary priorities. Yet, what happens if a country that the U.S. government, through the auspices of USAID, has deemed to be a high priority for HIV/AIDS prevention programs applies to the MCA only for infrastructure financing, for instance, to develop industrial capacity?

These critical questions about the internal MCA structure and practice will need to be answered if the MCA is to achieve its goals and win congressional approval. To minimize duplication and maximize the effectiveness of U.S. foreign economic cooperation, those answers can only be provided while considering existing programs.

Table 4: Annual Assistance Flows Relative to Staff for Select Bilateral Aid Agencies

Country/Agency	Total Staff	Net Official Development Assistance (ODA) ($ millions)	Net ODA/Total Staff ($ millions)*
MCA (proposed)	100	5,000	50.00
USAID	7,920	10,172	1.28
Luxembourg	14	83	5.93
Canada	1,286	2,032	1.58
Denmark	338	1,434	4.24
Finland	185	321	1.74
Belgium	360	644	1.79
United Kingdom	1,077	3,315	3.08
European Community	3,219	4,460	1.39

* This figure actually overstates the ratio of ODA to staff for existing agencies. Although staffing figures are provided for the primary aid agency in each country, net ODA is often administered by multiple entities. In a 2002 Development Cooperation report, the Organization for Economic Cooperation and Development found that USAID administers only about half of U.S. net ODA.

Sources: Organization for Economic Cooperation and Development (OECD), "Belgium," *Development Co-Operation Review Series*, no. 23 (1997); OECD, "Canada," *Development Co-Operation Review Series*, no. 26 (1998); OECD, "Denmark," *Development Co-Operation Review Series*, no. 33 (1999); OECD Development Assistance Committee, "European Community," *Development Co-Operation Review Series*, no. 30 (1998); OECD, "Finland," *Development Co-Operation Review Series*, no. 31 (1999); OECD, "Luxembourg," *Development Co-Operation Review Series*, no. 32 (1999); OECD, "United Kingdom," *Development Co-Operation Review Series*, no. 25 (1997); OECD, "United States," *Development Co-Operation Review Series* (2002); U.S. Department of State, briefing on the "Millennium Challenge Corporation," Washington, D.C, November 25, 2002. All figures converted to 2001 dollars.

What about USAID?

Over the past 30 years, every administration has tried to reform USAID. The Bush administration has decided instead to design its proposals around it. Even though development experts advocated from the beginning that an institutional home for the MCA should be created as an autonomous entity within USAID, it is revealing that most of the internal administration debate revolved around either housing it within the U.S. Department of State or establishing an independent corporation overseen by that department.[15] With the proposed creation of the MCC and the Department of Homeland Security, Bush will have earned the double-edged distinction of creating more new government agencies than any president since Jimmy Carter. One can only imagine that administration officials found it uncomfortable to choose between a near doubling of the budget of the much-maligned USAID or creating yet another bureaucracy.

Far from rendering USAID irrelevant, however, the MCA proposal has placed it squarely in the spotlight. To transform U.S. development policy successfully, the proposal must articulate a clear division of labor between the MCC and USAID as well as other programs for developing nations, such as OPIC and the Trade and Development Agency (TDA), or further exacerbate mission drift and duplication. In considering the MCC's relationship to USAID, it is useful to focus separately on those current USAID beneficiaries that qualify for the MCA and those that just miss being MCA eligible.

Aid should be integrated with trade and investment cooperation and debt relief.

As explained earlier from data in table 3, the MCC would likely operate initially in countries that currently account for one-quarter of USAID's core development assistance and a high share of politically directed assistance that the State Department allocates and USAID manages. One could imagine a variety of scenarios regarding MCC and USAID coordination within these countries. At one end of the spectrum, MCA qualification could mean that USAID would pack up its bags and move elsewhere—the cleanest distinction between their missions. In a more realistic scenario, the MCC might provide funding for the local government's top priority programs while USAID maintained programs in areas of high priority to the United States, such as child survival and health and HIV/AIDS prevention. Indeed, local officials might game the system, applying to the MCC for program support in other areas, knowing that USAID would continue providing funds for U.S. priorities. Instead of a division along programmatic lines, responsibilities might be divided according to the differential budget authorities of the two agencies, with USAID continuing to invest in nonrecurring expenses such as teacher training and technical assistance while the MCC specialized in capital expenditures such as school buildings and recurring costs such as teacher salaries. Another alternative would have USAID continuing to focus on social sectors while the MCC became more focused on the private sector.

All of the scenarios where USAID and the MCC both operate in the same countries blur the sharp identification of the MCC with the best performers. Moreover, from a practical standpoint the administration has not yet determined what would happen to USAID mission staff in those countries where the MCC is likely to operate. Certainly, it would be wasteful to duplicate staff presence in the field; but USAID staff's assistance with both the preparatory work and with contracting for, monitoring, and evaluating MCC programs would suggest a troubling misalignment of USAID staff's incentives and responsibilities as well as heavy MCC dependence on USAID.

Additionally, for those near-miss countries that fail to qualify for the MCA by virtue of one or two indicators or are just below the median on several indicators, it is not clear whether the MCC or USAID would take lead responsibility. This question is particularly important because it is in precisely such near-miss countries that the promise of vastly increased foreign assistance could be catalytic in encouraging policy reforms (in contrast to poorly performing states, where the government is unlikely to possess the capacity to close the gap). Moreover, this category is likely to include some developmentally important countries, such as Uganda, which has become a poster child for developmental virtue, with the glaring exception of governance. One possible solution for near-miss countries is that limited MCA funding could initially be made available to address areas where performance is below the median but evaluated separately and managed through USAID on the presumption that the arrangement would require greater oversight and involvement than normal MCA grants would.

Congress must be a committed partner if the MCA is to break new ground.

The current proposal has some bizarre implications even for the clearest hypothetical structure, in which the MCC operates in high-capacity countries and USAID works only in low-capacity countries. Assuming that USAID is left with three core missions—providing humanitarian assistance; helping postconflict countries through transitions; and addressing basic health, education, and governance challenges in poorly performing states—a greater preponderance of USAID programs would be directly related to foreign policy than ever before,[16] while in principle, the MCC's mission should be relatively free of foreign policy considerations. Yet, ironically, the administration's proposal gives the State Department the lead role on the board overseeing the pure development–oriented MCC while doing nothing to strengthen the department's input into USAID's increasingly foreign policy–oriented decisionmaking.

Important questions also arise about coordination among U.S. development programs more generally. Most obviously, the more the MCA moves in the direction of funding infrastructure and enterprise funds, the more it raises questions about overlap with OPIC, the Export-Import Bank, and TDA. Furthermore, U.S. development assistance will not achieve maximal efficiency and impact unless the aid is part of a coherent approach across all U.S. development programs, such as debt relief, U.S. trade preferences, and the credit-rating process.

The eligibility analysis described above makes clear that the creation of another independent agency with its own idiosyncratic conditions threatens to add to the confusion. It greatly increases the need for a strong mechanism to force interagency coherence, which does not exist currently. Moreover, smart development policy would encourage convergence toward a single hierarchy of eligibility criteria across programs over time, so that the most reform-oriented poor nations would automatically qualify for the most flexible terms on trade access, debt treatment, development assistance, and export and investment programs. Unfortunately, the obstacles are high, including jurisdiction problems across agencies within the executive branch and across committees in the legislative branch.

Congressional Oversight

Finally, Congress must be a committed partner if the MCA is to break new ground on development assistance. Only by striking a considered balance of obligations and authority between the executive and legislative branches will it be possible to pioneer a new approach centered on objective selection criteria, beneficiary-driven program design, and unprecedented funding flexibility. In short, for the MCA to succeed, it must forge a more effective partnership with Congress than USAID has. The MCA will be able to win such trust only if its program design contains adequate self-executing safeguards.

Many of USAID's inefficiencies stem from its interpretation of requirements imposed by Congress during the budget process. USAID shoulders one of the heaviest burdens of congressional earmarks—requirements setting aside specific amounts of its budget for particular purposes such as child-survival and health programs.[17] The agency is also subject to numerous policy directives—274 at last count.[18] In the colorful words of Senator John McCain (R-Ariz.), "Peanuts, orangutans, gorillas, neotropical raptors, tropical fish, and exotic plants also receive the committee's attention, though it's unclear why any individual making a list of critical international security, economic, and humanitarian concerns worth addressing would target these otherwise meritorious flora and fauna."[19]

Asked for the single best way to improve their performance, most USAID employees would opt for "notwithstanding authority"—the kind of flexibility that allows the Office of Foreign Disaster Assistance to move money rapidly to support newly identified needs. The "notwithstanding authority" approach makes it possible to bypass time-consuming contracting requirements and procurement regulations that often seem more focused on economic stimulus in the United States than in the beneficiary nation. Others have also emphasized the value of appropriating funds on a "no-year," or several-year, advance basis to avoid the poor incentives associated with a yearly "use it or lose it" funding cycle.[20]

To ask Congress to be judicious in applying its key instruments of control, however, the administration will have to put forward a design that builds in comparable self-restraint—for instance, on political interference—and self-executing safeguards against the misuse of funds. The combination of transparent and rigorous selection criteria, which limits eligibility to the best performers, and strong accountability through continuous monitoring and periodic evaluations moves in this direction but may prove insufficient.

In addition, the unpredictable nature of the congressional oversight process on foreign assistance may make it particularly difficult to craft such a procedural deal. In contrast to the normal reauthorization cycle of one to five years for most programs, the mammoth Foreign Assistance Act of 1961 has not been reauthorized since 1986. Although a handful of new assistance programs have been authorized since then, they have been accomplished through piecemeal legislation, and attempts at a more systematic overhaul have failed. Various reasons have been given, including deep ideological differences between key members on the committees that oversee foreign relations and the perception that foreign aid votes can only cause trouble for a member and never win favors.[21] Because Congress must vote on appropriations bills each year, much of the oversight normally assumed by the congressional authorizing committees has fallen to the appropriators instead.

A failed MCA could undermine political support for foreign assistance for decades.

Presumably, the administration would secure the best chances of achieving the desired procedural quid pro quo on MCC "flexible authorities" by showing appropriate deference to the authorizing committees. Although reauthorizing the Foreign Assistance Act would provide the best vehicle simultaneously to address the particulars of the MCA and to accomplish the vital task of clarifying the complementary mission of USAID, recent history suggests that a less ambitious, piecemeal approach has a far better chance of passage.

No Second Chances

The proposed creation of a $5 billion annual fund to promote growth in reform-oriented developing countries holds tremendous promise. At best, it could transform U.S. development policy, directing money to the highest-yielding social investments and forcing greater clarity of roles and missions among the many existing U.S. programs for developing nations. The pitfalls of such a plan, however, are sobering. If the selection process is overlaid with a geopolitical screen, if the MCA adds to the confusion surrounding USAID's mission, or if the MCA design does not contain adequate self-executing safeguards, the program will fall short of its goals. The negative repercussions could be as great as the positive potential would be.

A failed Millenium Challenge Account would quickly become yet another example—and the most expensive one—of the wasted aid cited by critics, and it could undermine political support for foreign assistance for decades to come. With this in mind, it is extremely important for the United States get it right the first time.

Notes

1. George W. Bush, remarks to the United Nations Conference on Financing for Development, Monterrey, Mexico, March 22, 2002.
2. "The Millennium Challenge Account," www.globalhealth.gov/mcafactsheet.shtml (accessed January 24, 2003) (fact sheet).
3. See *United States Leadership Against HIV/AIDS, Tuberculosis, and Malaria Act of 2002*, 107th Cong., 2d sess., S. 2525 (sponsored by Senator John Kerry [D-Mass.] and cosponsored by Senator Bill Frist [R-Tenn.] and others; introduced on May 15, 2002); George W. Bush, State of the Union Address, January 28, 2003.
4. This discussion owes a great deal to Gayle Smith's input as part of the Brookings Institution/Center for Global Development project.
5. This amount includes funds from the "150 account," the budget account for International Affairs, but excludes other important categories of U.S. aid such as military assistance and some forms of food aid and infectious disease–related assistance funded through the Departments of Agriculture, Health and Human Services, and Defense.
6. George W. Bush, remarks at the Inter-American Development Bank, March 14, 2002 (hereinafter Bush IADB remarks).
7. David Weiner, "U.S. Foreign Assistance and the War on Terrorism," working paper by the Center for Global Development, July 2002.
8. Bush IADB remarks.
9. American Council for Voluntary International Action, "The Millennium Challenge Account," May 2002, www.interaction.org/library/millenium.html (accessed January 24, 2003) (hereinafter InterAction Policy Brief); Larry Nowels, "The Millennium Challenge Account: Bush Administration Foreign Aid Initiative," *CRS Policy Brief*, April 29, 2002; Steve Radelet, "Qualifying for the Millennium Challenge Account," Center for Global Development, December 13, 2002, www.cgdev.org/nv/Choosing_MCA_Countries.pdf (accessed January 24, 2003).
10. Dani Rodrik and Francisco Rodriguez, "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," in *Macroeconomics Annual 2000*, eds. Ben Bernanke and Kenneth S. Rogoff (Cambridge: MIT Press and National Bureau of Economic Research, 2001).
11. See Radelet, "Qualifying for the Millennium Challenge Account."
12. Daniel Kauffman and Art Kray, "Governance Indicators, Aid Allocation, and the Millennium Challenge Account," World Bank, December 2002, www.worldbank.org/wbi/

governance/pdf/gov_indicators_aid.pdf (accessed January 24, 2003) (draft paper).

13. For the list of countries likely to be eligible for the MCA, see Radelet, "Qualifying for the Millennium Challenge Account."
14. For greater detail on the UN Millennium Development Goals, see United Nations Department of Economic and Social Affairs, "Millennium Indicators Database," December 19, 2002, http://millenniumindicators.un.org/unsd/mi/mi_goals.asp (accessed January 24, 2003).
15. InterAction Policy Brief; Steve Radelet, "Beyond the Indicators: Delivering Effective Foreign Assistance through the Millennium Challenge Account," Center for Global Development, September 10, 2002, www.cgdev.org/nv/MCA_indicators.pdf (accessed January 24, 2003) (working paper).
16. This point was brought to my attention by Gayle Smith of the Brookings Institution/Center for Global Development project.
17. Nowels, "The Millennium Challenge Account."
18. David Weiner, "A Portrait of the U.S. Development Assistance Program," Center for Global Development working paper, July 2002.
19. John McCain, statement on the foreign appropriations bill for fiscal year 2002, October 24, 2001.
20. Carol Lancaster, "The Devil Is in the Details: From the Millennium Challenge Account to the Millennium Challenge Corporation," Center for Global Development, December 11, 2002, www.cgdev.org/nv/Devil_in_the_Details.pdf (accessed January 24, 2003).
21. Carol Lancaster, *Transforming Foreign Aid: United States Assistance in the 21st Century* (Washington, D.C.: Institute for International Economics, 2000).