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THE OTHER WAR

Global Poverty and the Millennium Challenge Account

Lael Brainard, Carol Graham, Nigel Purvis,
Steven Radelet, and Gayle E. Smith

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President Bush's Millennium Challenge Account (MCA) initiative stands to increase U.S. foreign assistance by \$5 billion per year over current levels. The United States now has an opportunity to reshape the image it presents to the world's poor, but the risks are as great as the promise. The MCA will be most effective only if it addresses the chronic tension between foreign policy and development goals in U.S. foreign assistance and builds on international efforts to coordinate assistance, and its mission is designed to complement USAID rather than contribute to the proliferation of U.S. programs targeting developing nations.

A panel of experts from the Brookings Institution and the Center for Global Development have co-authored a new book, *The Other War: Global Poverty and the Millennium Challenge Account*. Attached is the book's executive summary--a concise version of the authors' recommendations.

The Authors

LAEL BRAINARD

Project Director, Brookings/CGD Project on the Millennium Challenge Account; Senior Fellow, Foreign Policy and Economic Studies and the New Century Chair, Brookings

CAROL GRAHAM

Vice President and Director, Governance Studies, Brookings

NIGEL PURVIS

Brookings Scholar on Environment, Development and Global Issues

STEVEN RADELET

Senior Fellow, Center for Global Development

GAYLE E. SMITH

Former Senior Director for African Affairs, National Security Council;
Guest Scholar, Governance Studies, Brookings

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The Brookings Institution
1775 Massachusetts Ave NW
Washington DC 20036
(202) 797-6000
www.brookings.edu

The Center for Global Development
1776 Massachusetts Ave. NW, Suite 301
Washington DC 20036
(202) 416-0700
www.cgdev.org

THE OTHER WAR GLOBAL POVERTY AND THE MILLENNIUM CHALLENGE ACCOUNT

A RARE AND IMPORTANT OPPORTUNITY

In March 2002 President Bush announced his intention to request an increase of \$5 billion per year over current assistance levels through the creation of a bilateral development fund, the Millennium Challenge Account. To implement the program, the administration subsequently recommended the creation of an independent agency, the Millennium Challenge Corporation (MCC), to allocate the new funding on the basis of objective selection criteria, measuring a nation's commitment to "governing justly, investing in people, and encouraging economic freedom."

The United States has a vital national interest in being a good development partner to the many countries around the world struggling with poverty. The proposed Millennium Challenge Account (MCA) would amount to a doubling of U.S. bilateral development aid—the largest increase in decades. It presents a rare opportunity to create a new blueprint for distributing and delivering aid effectively. For these reasons the MCA offers a critical chance to deliberately shape the face that the United States presents to people in poor nations around the world.

IMPORTANT RISKS

Although the MCA is enticing, there are many ways to squander this opportunity. This initiative will fall short unless it squarely addresses the tension between foreign policy and development goals that chronically afflicts U.S. foreign assistance. It will fall short unless there is a clear vision of how the MCA can complement rather than exacerbate the myriad of overlapping policies, agencies, aid programs, and eligibility criteria targeted at developing nations, particularly USAID. The president's decision to establish an independent agency was a clear vote of no confidence in the 10,000-strong Agency for International Development (USAID), which will retain responsibility for providing foreign assistance to the vast majority of the world's poorest. And finally the MCA will fall short if it is interpreted as one more instance of the United States going it alone instead of buttressing international cooperation in the fight against global poverty. These are serious risks.

Risk 1: The Tension between Development and National Security in U.S. Aid

The risks of geostrategic creep are acute, because the MCA is being crafted at a time when security has returned to the forefront of the nation's consciousness to a degree not seen since the cold war. Indeed, in a speech to the IADB, President Bush cited terrorism as a central rationale for the creation of the MCA: "We also work for prosperity and opportunity because they help defeat terror. Yet persistent poverty and oppression can lead to hopelessness and despair. And when governments fail to meet the most basic needs of their people, these failed states can become havens for terror."

A core tenet of the MCA is that it would be protected from political interests and committed to supporting the “best performers” in the developing world. These countries may or may not be prominent allies in the U.S. war against terrorism. With allocations based solely on economic performance and governance, the MCA would be the closest to a development purist’s blueprint for aid that the United States has ever attempted. 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, to shore up “frontline” states, and to stabilize failed states. In fact few such countries could meet the MCA’s economic performance and governance tests.

Tensions between those two objectives are already evident. The administration’s November 2002 decision to expand the MCA pool of eligible countries to include lower-middle-income countries had the effect of adding nations where America has important foreign policy objectives and large politically motivated foreign aid programs, such as Russia, Jordan, Egypt, Colombia, and Peru. In fiscal year 2002 these five nations received \$1.32 billion in U.S. economic assistance—one-fifth the total of nonemergency aid. The MCC—which has been given a “pure” development mandate—will be established independently of the USAID, the federal agency that has international development as its core mandate. The MCC board will be led by the Department of State, which has foreign policy as its primary objective, and will not include USAID.

Risk 2: Another Instance of Unilateralism?

It would be a terrible irony if the laudable goals of the MCA were undercut by perceptions that it is one more instance of the United States going it alone. But the risk of adding to concerns about unilateralism is real, since both the MCA and the president’s Emergency Plan for AIDS Relief bypass international efforts and existing aid agencies in favor of U.S. programs with idiosyncratic eligibility criteria and newly invented institutional arrangements.

The Bush administration’s legislative proposal for the MCA appears curiously uninformed by efforts to coordinate and cooperate at the international level. The past several years have seen an emerging, unprecedented consensus on the policy environment and objectives conducive to poverty reduction and growth and on making aid more effective, including by ensuring greater coordination among donors in support of plans designed and implemented from the bottom up. The president’s announcement was made in anticipation of the UN Conference on Financing for Development, a summit designed to secure increases in funding for international development and poverty reduction efforts, with special reference to the UN millennium development goals. It is surprising that the proposed *Millennium* Challenge Account makes no reference to the UN *millennium* development goals (MDGs), the internationally agreed-upon quantifiable targets for halving poverty and improving health, education, and environmental outcomes by 2015.

Risk 3: Adding to the Morass of Overlapping Programs and Goals

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. Not only would the MCA succeed in its own right but it would 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 more clearly focus on challenges that the MCA does not address.

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 the MCA could become the preferred fund, not only for the best performers but also for politically salient countries. This outcome could very well emerge if the increased calls on aid for geopolitical reasons and the rapidly deteriorating budgetary environment conspire to undermine the MCA's purity. In this case the lines between the MCA and other forms of assistance would blur, and Congress would feel compelled to constrain the MCA as it currently constrains existing assistance programs.

At the other 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 AID would remain the main source of U.S. funding for the far more numerous, less capable countries. Countries initially eligible for the MCA would likely include only 13 percent of the population of sub-Saharan Africa, the poorest region of the world.

The combination of growing challenges and tighter resources raises the stakes. Vast new foreign assistance needs are anticipated relative to coalition building and reconstruction as well as the skyrocketing costs of combating the HIV/AIDS pandemic. Meanwhile the budget outlook is growing worse. Even though it is a presidential initiative, the administration has already scaled back its initial MCA request to Congress, and it is extremely unlikely it will reach \$5 billion in the promised three years—or perhaps ever. There is an even greater danger that the less prominent and less popular programs administered by USAID will be progressively squeezed over time, even though the need is as great as ever, due to a combination of budget pressures and deterioration in the beneficiary pool, as the best performers move to the MCA.

KEY DRIVERS OF SUCCESS

Welcome as they are, new money and a good idea are not enough. Critical design and implementation decisions require urgent attention for the new fund to succeed on its own terms, as well as to strengthen international cooperation and broader U.S. foreign assistance policy. *The Other War: Global Poverty and the Millennium Challenge Account* identifies ten key drivers of success and provides recommendations for each.

Driver 1: Piggyback on and Learn from International Efforts

Even if the MCA succeeds on its own terms, it may fail in making the United States a more effective development partner, unless greater effort is made to ensure coherence among the many U.S. programs and agencies oriented toward development and greater effort is made to work with and learn from international efforts more broadly. The MCA cannot and should not go it alone in crafting development aid. Lack of coordination among donors has been an important contributor to the poor record of international aid.

Recommendation: Don't Go It Alone

- ❑ American taxpayer dollars could be greatly leveraged if they piggybacked on the efforts of the World Bank to pioneer the country ownership model that animates the MCA—putting resources

toward the development strategies and plans developed by governments, with input from civil society as a central element.

- ❑ The MCC should consider consistency with the Millennium Development Goals (MDGs) in its grant-making and include MDG targets in its assessments where appropriate.
- ❑ The Global Fund to Fight AIDS, Tuberculosis, and Malaria (Global Fund) provides the most relevant set of comparisons and contrasts on the demand-driven, results-oriented grant-making approach, based on competition among locally designed proposals.
- ❑ On selection criteria, the highly indebted poor countries (HIPC) debt relief initiative may provide the most interesting parallel.

Driver 2: A Narrow Core Mission

In contrast to the sprawling mission and multiple objectives of USAID, the MCA should develop a core competence around a limited set of areas in order to achieve greatest effectiveness. *The MCA mission should be to support growth, poverty reduction, and sustainable development by underwriting meritorious strategies designed and implemented by poor nations with good governance, economic policy, and social investment.*

Four key criteria should determine the sectors on which MCA should focus its grant making:

- ❑ evidence that the sector is an important determinant of growth and poverty reduction;
- ❑ inclusion of the sector in the MDGs, whose importance to poverty reduction is a matter of international consensus;
- ❑ evidence that public intervention is needed in the sector to address areas where private investment falls short of the socially desirable level;
- ❑ an established track record of foreign aid delivering results in the sector and evidence the U.S. has particular expertise and experience.

The compatibility between a program area and the demand-driven, recipient-led approach of the MCA should also be considered.

Recommendation: The core focus of MCA should thus encompass five areas and reserve a final area for further study:

Core Competence: Basic Health

Basic health should be a priority focus of the MCA because of its clear role in poverty reduction and growth, the compelling case for public intervention, and the impressive record of official assistance—in areas like vaccines and oral rehydration therapy—that have led to measurable and highly cost-effective improvements.

Core Competence: Primary Education

Targeting primary education for all girls and boys should be a priority focus of the MCA. Primary education has obvious direct economic benefits but also important indirect benefits. Foreign aid's record, while mixed, holds out hope for good outcomes from well-designed programs that focus on the quality and not just the quantity of educational attainment.

Core Competence: Environmental Sustainability and Clean Energy

Ensuring sustainable resources as well as safe water and clean air should be a core focus of the MCA based on the criteria above. The absence of the environment from the administration's proposal is a startling omission, especially since it has been a high priority for the United States historically. Pressing immediate economic needs and poor environmental regulatory capacity in many poor countries result in unhealthy air and water, irreversible tradeoffs between the interests of current and future generations, and harmful spillovers to people living outside the border. The case for foreign aid to rebalance the equation is strong. Developing countries are also eager to obtain the most modern clean energy technologies available. The MCA should follow all other U.S. aid, trade, and investment programs and require environmental impact analyses of relevant grants.

Core Competence: Agricultural Development

Agriculture should be a core focus because of its central role in employing the majority of the workforce and as the initial driver of productivity and growth in many poor nations. However, it is important for foreign aid programs to avoid competing with private sector activities. The MCA should target collective goods that are underprovided by the market and where assistance can be put to good use, such as rural infrastructure, applied research, and collective marketing arrangements.

Core Competence: Strengthening the Policy Environment for Private Sector Development

The MCA should strengthen the policy environment for private sector development. There is no compelling reason to single out (as the administration proposes) policies on trade and foreign investment as more important to a dynamic private sector than, for instance, financial market supervision, bankruptcy, competition policy, and regulations conducive to small business creation. The MCA should not support enterprise funds or other direct financing to business—with the possible exception of microfinance. The MCA's grant-making approach is ill-suited to the role of financial intermediary, the record of U.S. government enterprise funds is mixed, and the MCA should not duplicate the work of existing U.S. and multilateral institutions dedicated to financing trade and foreign investment.

Further Study: Governance

Although governance meets many of the above criteria, it differs from the program priorities recommended above in that there is uncertainty about the demand in potential recipient countries and compatibility with the MCA approach. To ascertain the extent of demand before building in-house expertise at the MCA, we recommend that the MCA encourage the submission of governance proposals but initially subcontract out (on a reimbursed basis) any such proposals to USAID for assessment and monitoring and evaluation. On democracy, in contrast, the small staff of the MCA is ill suited to the intensive hands-on nature of democracy programs, and USAID should retain responsibility.

Driver 3: Getting the Country Coverage Right

The administration's proposal to broaden the eligibility pool in year three to include countries with incomes between \$1,435 and \$2,975 has raised concerns that resources will be diverted from countries with far greater needs. Although some countries in this richer group have many people living in poverty, they have access to a wider array of financial resources to address these problems. The

second concern is that the richer group includes several countries that are currently among the largest beneficiaries of politically directed U.S. assistance, raising the risk that the MCA could be used to replace current aid flows for those that qualify.

Recommendation: Keep the Focus on the Poorest Countries

- ❑ Countries in the \$1,435 to \$2,975 income range should continue to have access to traditional forms of U.S. assistance, rather than being included in the MCA.
- ❑ If the richer countries are included, we recommend excluding those countries that receive significant funding from U.S. political foreign aid accounts, such as Economic Support Funds, and require a two-year cooling-off period between the time political aid ends and MCA funding begins. This will guard against geopolitical creep, without unfairly excluding meritorious lower-middle-income countries with high poverty (such as South Africa). In addition a ceiling (up to a maximum of \$1 billion per year) should be put on funds available to the lower-middle-income group.
- ❑ Within the narrower income range, we recommend that MCA-eligible countries be split into two groups, the first with incomes of \$875 or less—the World Bank’s current operational cutoff for IDA (International Development Association) eligibility, and the second with incomes between \$875 and \$1,435—the World Bank’s historical cutoff for IDA. Structuring the selection so that the two groups compete separately for funding is likely to broaden the group of the poorest countries that meets the selection criteria by enabling them to compete only against nations at a similar level of poverty.

Driver 4: Getting the Selection Process Right

The administration has highlighted the selection criteria as the defining aspect of the MCA. Getting the selection criteria right is, therefore, absolutely critical. The data are unlikely to be fully up to the task, however, creating inevitable scope for discretion (which in turn puts greater onus on the board and the statutory mandate of the MCA, as discussed below). The list of countries generated by the dry run of the selection methodology in chapter 3 includes many countries that would seem appropriate for the MCA but also yields some surprises, such as Egypt and Vietnam, that seem inconsistent with the MCA’s general policy thrust. These problems suggest several modifications to the selection process:

Recommendation: Reduce Reliance on the Median as the Hurdle

- ❑ The selection criteria will not provide effective incentives for reform if they are moving targets. The administration should move as quickly as possible to adopt absolute hurdles for as many indicators as possible, as is already the case for inflation, perhaps using the medians from the first year as a guide.
- ❑ The analysis also would suggest setting the hurdles *at* rather than above the median, a small modification that would achieve broader coverage among poor countries without any sacrifice of rigor.
- ❑ The administration should refine some of the indicators that measure countries (with error) on a very narrow scale, such that most countries are bunched together at or near the median. The Heritage Foundation/Wall Street Journal trade policy index is the weakest indicator in this area, but the Freedom House civil liberties and political rights indexes are also of concern. In these

cases, a country whose performance is above the median but is measured poorly could be erroneously excluded, and the reverse.

Recommendation: Change Treatment of Corruption

The data used to measure corruption are not robust and accurate enough to be the sole basis for eliminating countries regardless of their performance in other areas. As an alternative, the worst corruption offenders, where the data indicate a 75 percent chance or greater that the true score is below the median, could be eliminated immediately.

Recommendation: Improve the Indicators

As discussed above, HIPC underwent a major revision to its selection indicators three years after its inception, as the operational implications became clear. The architects of the MCA would be wise to build in a process for refining the selection methodology early in the life of the program.

- ❑ The administration should commission other indicators that could be used in place of or to supplement the indicators with evident weaknesses. Most immediately, the four indicators for investing in people should be expanded to include the ratio of girls to boys in primary schools and primary school enrollment rates, plus one additional measure of health outcomes. On a somewhat longer schedule, the MCA should address the weakness of the trade index by working with the World Trade Organization and the United Nations to access data on actual barriers to trade.
- ❑ The selection process raises many complex technical issues that have important implications for MCA coverage. To thoroughly address these issues on a regular basis, the administration and Congress should establish an independent panel of outside experts to review the selection methodology on an annual basis.
- ❑ Procedurally a tradeoff exists between establishing a stable set of incentives for applicant countries and improving the data and methodology over time. A similar tradeoff exists between ensuring congressional policy direction on the indicators and permitting the administration discretion to change them in response to experience. Congress could provide policy guidance in the authorizing legislation on the key categories for the selection process and income groups and require the administration to undertake a regulatory process for implementing and revising the selection criteria, with the usual provisions for public comment.

Driver 5: A New Approach to Aid

The MCA should pioneer a sharply different approach to aid, one that places responsibility and accountability squarely in the hands of eligible countries, even as it seeks to build local capacity from proposal design through implementation and assessment of results. Our analysis strongly endorses the spirit of working in partnership with developing countries to achieve their own development strategies.

Recommendation: Balance between Contract Specificity and Flexibility for Innovation

The concept of a contract between the MCA and grant recipients is useful in defining responsibilities and authorities on both sides. But the contractual precision should be tempered by realism about the

inherent long-term and risky nature of development process. The MCA should expect disappointments and even outright failures; to do otherwise would discourage innovative proposals.

Recommendation: Selecting the Best Proposals

- ❑ Once countries have been selected, the MCA should hold an open competition for the best grant proposals on a regular schedule, twice a year, so that all proposals in each round can be compared against each other fairly. The core assessment of competing proposals should be undertaken by country-sector teams that incorporate the views of experts from inside the MCA and other relevant U.S. agencies as well as external experts on every proposal. This would also take into account input from the field and on technical feasibility.
- ❑ Board review would be required for grant proposals that are controversial or exceed 5 percent of either the MCA annual budget or the budget of the grant recipient.

Recommendation: Ensuring Participation by NGOs and the Private Sector

- ❑ The MCA should strike a balance, appropriate to the circumstances of each country, between strengthening the capability of the government and ensuring active space for civil society. This suggests a hybrid approach on the question of what kinds of organizations should be eligible to submit grant proposals, one less restrictive than the government-only focus of the administration's proposal. This can be accomplished by encouraging but not requiring national governments to submit proposals that coordinate the activities of a range of actors—national, subnational, nongovernmental, and for-profit—while also leaving room for NGOs and subnational governments to submit proposals independently.

Recommendation: Flexibility on Funding Modalities

- ❑ The MCA should have substantial flexibility in tailoring financing modalities to the particular country and sectoral emphasis of each proposal. It must have the capacity to fund programs and not just projects and to underwrite recurring expenses, such as operating costs, maintenance, and salaries, as well as capital or one-time costs.
- ❑ Although program funding has risks, there are also compelling advantages. With program funding going through the budget, the focus of attention would shift to strengthening government institutions rather than hollowing them out. Donor monitoring can examine the entire budget, thus reducing the opportunities for governments to divert money to questionable items. Over time, requiring that proposals be presented in the context of the national budget will help strengthen the budget as a process for defining national priorities and facilitating debate about tradeoffs.

Recommendation: Monitoring and Evaluation of Concrete Outcomes

- ❑ Strong monitoring and evaluation are critical to the MCA's success. Monitoring and evaluation should include four elements: financial audit, measuring progress on the concrete outcomes targeted by the grants, strengthening the internal capacity of the recipients for self-evaluation, and assessing the potential for scaling up or replication elsewhere.

Driver 6: A New Bureaucracy?

Many elements of OPIC and Ex-Im and the enterprise funds are suggestive for the MCA on governance, status, and staffing. USAID, with its wide range of programs and missions, provides a rich set of both positive and negative examples.

Perhaps the hardest-fought issue in the administration's internal deliberations on the MCA was where to house it. The State Department was ruled out, correctly in our judgment. The perception if not the reality of a foreign policy overlay to the selection process would have been unavoidable, and the lack of program experience was equally compelling.

Compelling arguments can be made on both sides of the choice between creating a stand-alone independent agency and an autonomous entity affiliated with USAID. If the goal is to ensure the success of the MCA in its own right, a new independent agency is the right way to go, even as this assumes heavy reliance on support from USAID. If the goal is to make U.S. foreign assistance and development policy more powerful, the creation of two federal agencies to administer development assistance defies policy and budgetary sense. The waste associated with bureaucratic redundancy, the potential for duplication and overlap, including in the field, and the likelihood of an implicit cross-subsidization from USAID to the MCC will be hard to avoid.

Recommendation: Affiliate MCA with USAID but Build in Safeguards

- ❑ On balance, we find the case for designing the MCA to strengthen U.S. development policy compelling and therefore urge consideration of affiliating the MCC with USAID.
- ❑ Although the administration is right to worry about the dangers of subjecting the MCC to the same type of restrictions and bureaucratic habits afflicting many programs at USAID, there are ways to minimize these risks. Building on the precedent established by the enterprise funds, the MCC could be established as an autonomous entity affiliated with USAID, with its own chief executive officer at a deputy administrator rank, an independent board, and a separate authorization from Congress.
- ❑ Recognizing that the creation of a new agency is the more likely course, our recommendations are designed to apply to either type of entity equally.

Recommendation: Expand the Board to include Outside Representatives and USAID

- ❑ An independent board should govern the MCC.
- ❑ Drawing on the experience of OPIC and Ex-Im, eight board seats should be divided equally between administration representatives and outside members recommended by Congress on a bicameral and bipartisan basis to serve six-year terms.
- ❑ We concur with the administration's proposal that the secretaries of state and treasury be on the board, but disagree that the Office of Management and the Budget would be an appropriate board presence, given its role as budget referee. Moreover the omission of USAID from the board is anomalous, especially given the extensive support envisaged from USAID and the importance of avoiding wasteful duplication and turf battles. A variety of possible agencies could be appropriate for the final board seat.
- ❑ The experience of comparable independent agencies suggests a board composed heavily of representatives of other federal agencies is a mixed blessing: although it brings useful breadth of perspective, it may also subject the agency to political pressure to help further outside agendas. For this reason, budget transfer authority should remain with Congress (rather than being delegated to

the MCC, as proposed by the administration) to diminish pressures to disburse MCA monies through other federal agencies.

- ❑ We recommend that accountability and authority should be aligned by giving the CEO a seat on, and preferably leadership of, the board.¹ The experience of OPIC and Ex-Im suggests that Cabinet secretaries rarely if ever attend board meetings and instead delegate representation to lower-level officials.

Recommendation: Independent, Professional Staff

- ❑ The MCC should be a lean organization, relying on outsourcing where it is cost effective and requiring fewer program staff than traditional U.S. assistance programs, because of the emphasis on country ownership and program support. Interagency detailing should be used to promote coherence and draw on expertise, as should limited term appointments from the private and nongovernmental sectors.
- ❑ The administration's proposed staff size of 100 to administer \$5 billion in grants annually is unrealistic. A comparison with other bilateral aid agencies and private foundations suggests that program funding of \$5 million per staff member per year is ambitious—a sobering contrast to the administration's implied \$50 million per staff member per year. A more realistic size could be two to four times greater.
- ❑ Both headquarters and overseas staff of the MCC should be detailed only on a reimbursable basis, to ensure that there are no hidden subsidies and that program evaluation is on the basis of all-in costs.
- ❑ Private sector entities should be prohibited from detailing paid staff to avoid conflicts of interest.

Recommendation: Build Recipient Capacity

- ❑ The MCC should enhance the ability of MCA countries to implement grant programs by including training and capacity building components in all technical assistance, financial management, and other relevant assistance programs. It should allow competition for procurement and other service contracts by MCA country institutions and expedite the registration process for these entities.

Driver 7: Greater Coherence in U.S. Foreign Assistance and Development Policy

Although the president's decision to establish an independent agency was a clear vote of no-confidence in USAID, the administration has not put forward any proposals to fix the agency, which will retain responsibility for providing foreign assistance to the vast majority of the world's poorest. Since the Marshall Plan in 1948, six separate agencies have been created to address international development—only one of which exists today. Unlike past efforts, the MCC would create a new development agency without either replacing or triggering the reorganization of already existing foreign assistance programs.

It is ironic that, with clearly defined and separate missions, a greater preponderance of USAID programs would be directly related to foreign policy than ever before, while the MCC's mission would be relatively free of foreign policy considerations. Yet the administration proposes that the board of the development-oriented MCC be chaired by the Secretary of State Department and not include the head of USAID.

Recommendation: Clear Division between USAID and MCC

- ❑ A clear division of labor must be established between USAID and the MCC (whether as a new agency or as part of a merged entity). The MCA should not rely on implicit cross-subsidization and support from USAID through details that are not reimbursed or support from USAID mission staff on the ground, as currently envisaged in the administration's proposal. To do so would create wasteful duplication and needless turf fights, would muddy program evaluation, and would further diffuse USAID's mission and undermine morale.
- ❑ In a strict sense, this implies that once a country qualifies for the MCA, with some transition period, USAID operations should shut down in that country.
- ❑ In near-miss countries, which fail narrowly to qualify for the MCA, 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. We recommend that limited MCA funding be made available as challenge grants to address those areas that are weak, but under USAID's supervision, to provide greater oversight.

Recommendation: Sharpen USAID's Mission

Greater clarity must be given to USAID's core mission. USAID would retain responsibility for five goals:

- ❑ providing humanitarian assistance;
- ❑ supporting development in geopolitically important countries;
- ❑ countering the threat posed by weak and failing states;
- ❑ helping postconflict countries through transitions; and
- ❑ addressing basic health, education, agriculture, policy, and governance challenges in moderate-to-poorly-performing poor countries.

Driver 8: Bringing Coherence to U.S. Development Policy

The creation of another independent agency to support international development with its own idiosyncratic conditions threatens to add to an already confusing proliferation of U.S. programs and agencies. U.S. development assistance will not achieve maximal efficiency and impact unless the aid is part of a coherent approach that includes debt relief, trade and investment programs, and technical assistance. Especially for the most reform-oriented countries singled out by the MCA, the prospects for graduating rest centrally on improved trade and investment prospects. It makes little sense to grade a country on its trade openness, provide foreign aid to improve its trade regime, and then provide less favorable trade access to the U.S. market than is available to other countries (who might be politically more important but less committed to market reform). This argues for an integrated approach to determining the appropriate terms on trade access, debt treatment, development assistance, and export and investment programs for each country.

Recommendation: Improve Development Policy Coordination

- ❑ The administration should mandate a policy coordination process, led from the White House using existing National Security Council (NSC) and National Economic Council (NEC) mechanisms, to ensure deployment of all the tools in the U.S. arsenal in a mutually reinforcing way to assist poor countries make the transition to sustained growth. This should include foreign aid, technical assistance, debt relief, trade preferences or free-trade agreements, export credits, and investment support and agreements.

Driver 9: Financing Foreign Assistance

The administration's promised funding for the MCA represents a near doubling of existing U.S. bilateral development assistance, but existing levels are low, both relative to other donors as a share of income and relative to U.S. politically allocated economic assistance. It would increase the share of U.S. income devoted to official development assistance from the current 0.10 percent to nearly 0.15 percent, a significant increase but nonetheless well below the OECD average of 0.33 percent and the international target of 0.70 percent. The MCA could make an important but manageable contribution to the resources available to poor countries, and as such it represents a sizeable but incomplete U.S. contribution to international efforts to address global poverty and achieve growth.

Recommendation: Prevent Budget Squeeze on Less Popular Programs

- ❑ In the years ahead it will be important to examine the foreign aid budget in fine-grain detail to ward against the danger that programs with lower public salience will get squeezed. Traditional development assistance (DA) is particularly vulnerable, due to a combination of budget pressures and deterioration in the beneficiary pool, as the best performers migrate to the MCA, but it is critically important in reaching some of the world's neediest populations. Already the administration has proposed cuts for funding for child survival and maternal health programs unrelated to HIV/AIDS to make room for the new priorities.

Recommendation: Prevent Geopolitical Creep

- ❑ Continued scrutiny is also important to guard against the danger that the MCA may become the central source of economic assistance to geopolitically important countries that are part of the expanded lower-middle-income eligibility pool.

Recommendation: Deliver on the Promise

- ❑ If an agency is established de novo to implement the MCA, it is unlikely that it will be able to disburse the promised amounts while maintaining high standards in its first year of operation and possibly longer. It is nonetheless critical for U.S. credibility internationally to deliver on the promised funding levels. Congress should use a combination of advance appropriations and no-year money to ensure that the promised funds will be available when there is the ability to use them well, without tying up resources that are badly needed elsewhere.
- ❑ Already there are concerns that the MCA will not be fully funded. The administration's fiscal 2004 request for the MCA is 20 percent below the level initially proposed for the first year and falls well short of \$5 billion in 2006. Moreover, Congress looks set to cut these levels further in the face of an overall budget squeeze and expectation of large additional assistance needs associated with war and reconstruction in Iraq.

Driver 10: Forging a Partnership with Congress

The administration's proposal to create a new agency, the Millennium Challenge Corporation (MCC), to implement the MCA should be understood as a reaction in part to the perceived failure of the Congress and the president to work together effectively in the past on many foreign aid programs. The Congress and the president have an enormous opportunity to initiate a new partnership in designing the agency and its mandate.

Recommendation: Appoint MCA Representative Now

- ❑ To help the Congress and the president define the terms of the new partnership that is needed for the MCA, the president should quickly designate a personal adviser who could represent the administration before Congress in crafting the MCA legislation. The president could consider announcing that this individual would be his likely nominee to be the CEO of the MCC, should the Congress approve the creation of the agency. The experience with the authorization process for the Department of Homeland Security lends strong support to this recommendation.

Recommendation: Ensure Accountability to Congress

To ensure the accountability of the MCC, the Congress should prescribe and maintain input into the governing of the agency as well as the transparency of and public participation in the agency's decisionmaking. This should include mandating the following:

- ❑ a strong agency head, fully accountable for policy, with a seat and preferably leadership of the board of directors, as at Ex-Im;
- ❑ a board of directors, selected with input from the Congress, balanced between administration representatives and outside members, similar to OPIC;
- ❑ an adequate professional staff, some fraction of which should have civil service status, in the interest of institutional continuity and political independence, following Ex-Im and OPIC;
- ❑ independent agency status;
- ❑ the best monitoring and evaluation procedures, including periodic evaluations of the administering agency by the GAO;
- ❑ obligations to report regularly on priorities, expenditures, and performance, timed to coincide with reauthorization;
- ❑ a duty to notify the Congress in advance in extraordinary circumstances, such as grants of an unusually large size (this could be the same 5 percent trigger as that necessitates exceptional board review); and
- ❑ obligations to solicit public participation through web postings and comment solicitation.

Recommendation: Limited Term and Regular Reauthorization

As with Ex-Im and OPIC, the Congress should authorize the MCC for a limited term and require a regular reauthorization process. Balancing the need for congressional review to make adjustments to the MCC (especially in its early years) against the need to provide stable incentives for countries that are working to achieve eligibility suggests a six-year reauthorization cycle initially. The authorization process should do the following, at minimum:

- ❑ Spell out, in general terms, political factors (such as respect for human rights) that must be met for a government to receive funding. The administration has proposed incorporating the basic conditions on assistance in the Foreign Assistance Act.
- ❑ Set out the principles for country selection criteria, and require the president to adopt regulations for implementing and subsequently modifying them, in order to create stable incentives and minimize the scope for political manipulation.
- ❑ Set out the principles of program areas and entities eligible to compete for funds, and require the president to adopt regulations laying out standard procedures for the review of grant proposals.

Recommendation: Narrow Mandate

The Congress should give the MCC a narrow and clear mandate that would protect it from taking immediate foreign policy considerations into account, just as Ex-Im is required to make funding decisions based solely on commercial criteria. The MCC should support growth, poverty reduction, and sustainable development by underwriting meritorious programs designed and implemented by poor nations with a demonstrated record of sound policy, social investment, and good governance.

Recommendation: Operational Flexibility

Finally, certain of the Congress’s historic practices on foreign aid—including earmarking and tying aid, extraneous political tests rooted in domestic debates, and procurement and contracting rules better suited to domestic agencies—would be fundamentally incompatible with the demand-driven, competitive grant-making logic of the MCA. The Congress should grant the president significant operational flexibility to ensure that the MCC is responsive, efficient, and effective by doing the following by:

- ❑ appropriating funds free of earmarks or ties, to the extent practicable;
- ❑ appropriating no-year funds;
- ❑ exempting the MCC from contracting and procurement rules (or enacting new waiver procedures); and
- ❑ avoiding advance notification requirements for routine grant decisions.

ACHIEVING THE FULL PROMISE OF THE MCA

These recommendations are offered in the spirit of making the MCA succeed, both in its own right and in strengthening the U.S. partnership with developing countries more broadly. It is vital that the new resources be used to pioneer a dramatically new and more effective approach, by underwriting the most promising strategies proposed and implemented by poor nations committed to good governance and development. But success is by no means guaranteed. A failed MCA would quickly become yet another example—and the most expensive one—of wasted aid, and it could undermine political support for foreign assistance for decades to come. The United States must get it right the first time.

1. This recommendation is not shared by all authors.