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# *Introduction*

We meet at a moment of new hope and age-old struggle, the battle against world poverty. . . . We fight against poverty because hope is an answer to terror. We fight against poverty because opportunity is a fundamental right to human dignity. We fight against poverty because faith requires it and conscience demands it. And we fight against poverty with a growing conviction that major progress is within our reach.

—President George Bush, *United Nations Conference on Financing for Development, Monterrey, Mexico, March 22, 2002*

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 based on a nation's commitment to "governing justly, investing in people, and encouraging economic freedom."[1]

The proposed Millennium Challenge Account (MCA) is nearly double the size of existing U.S. bilateral assistance programs that are devoted specifically to development (as opposed to humanitarian assistance, politically directed aid, and other programs)—the largest increase in decades. It presents a rare opportunity to create from scratch a new blueprint for distributing and delivering aid effectively. For these reasons the MCA offers a critical opportunity to deliberately shape the face that the United States presents to people in poor nations around the world. This book examines how best to fashion the MCA to make it an effective tool, not only in its own right but also in transforming U.S. development policy and reinforcing positive trends in international aid cooperation.

Although the MCA presents an enticing opportunity, the risk is at least as great that the new fund will simply add to the confusion of overlapping policies, agencies, aid programs, and eligibility criteria targeted at developing nations. This initiative will fall short of expectations 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-eyed vision of how the MCA can complement the operations and country coverage of existing U.S. programs for developing nations, particularly those implemented by the U.S. Agency for International Development (USAID). The president's decision to establish an independent agency was interpreted as a vote of no confidence in the 10,000-strong 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.

## The Context: Global Poverty and the War against Terrorism

The risks are particularly acute because of the heightened sense of urgency about both global poverty and global terrorism, demands that may pull in different directions. 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 height of the cold war. Indeed 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."[2] But the central tenet of the MCA is that it would be committed to supporting the "best performers" in the developing world, regardless of whether these countries are political allies or strategic partners in the U.S. war against terrorism. With allocations based solely on economic performance and governance, the MCA would be protected from political interests and be the closest to a development purist's blueprint for aid that the United States has ever attempted. Indeed, 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.[3]

The broader international community is equally focused on the scourge of global poverty. In recent years donors and recipients have increasingly agreed 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. It is significant that President Bush announced the MCA in anticipation of the UN Conference on Financing for Development, a summit designed to secure substantial new funding aimed at growth and poverty reduction, with a special focus on achieving the UN millennium development goals (MDGs). The MDGs are internationally agreed-upon quantifiable targets for halving poverty and improving health, education, and environmental outcomes by 2015.[4]

President Bush's announcement of a $5 billion per year increase in bilateral aid was warmly welcomed by development advocates and poor nations. Together with other donor nations, the development community has lobbied for years for an increase in U.S. foreign aid and increased U.S. engagement in the fight against global poverty. Indeed President Bush made an indirect reference to this in his remarks: "All of us here must focus on real benefits to the poor, instead of debating arbitrary levels of inputs from the rich."[5] It is notable that, since the Monterrey summit, coordination with the efforts of other donors and with international financial institutions has been absent from the discussion, and the administration's draft legislation makes no reference to MDGs and scant mention of multilateral aid cooperation.[6] It would be a terrible irony if the MCA were seen as one more instance of American unilateralism. But this risk is real, since both the MCA and the president's Emergency Plan for AIDS Relief (proposed in the 2003 State of the Union address) bypass international efforts and existing aid agencies in favor of bilateral U.S. programs with idiosyncratic eligibility criteria and newly invented institutional arrangements.

## The Promise and the 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 with 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 a measure of independence from political meddling by the executive branch and the trust of Congress, freeing it from the burdensome restrictions and procurement requirements faced by other agencies. At best a successful MCA 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: 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.[7] 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.

In fact the administration's November 2002 decision to expand the MCA pool of eligible countries to include not just the poorest but also countries with per capita incomes up to $2,975 moved in precisely this direction, taking development advocates by surprise. With this change the eligibility pool encompasses nations that are already among the largest beneficiaries of politically directed U.S. assistance but that no longer qualify for concessional lending from the World Bank, such as Russia, Jordan, Egypt, Colombia, and Peru.[8] In fiscal 2002 these five nations received $1.32 billion in U.S. economic assistance—one-fifth the total of nonemergency aid.

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 a 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. Analysis presented in chapter 3 suggests that countries most likely to be initially eligible for the MCA include only 12 percent of the population of sub-Saharan Africa, the poorest region of the world. Prompted by this concern, critics have proposed greatly expanding the MCA's country coverage.[9]

The combination of growing challenges and tighter resources raises the stakes. Vast new foreign assistance needs are anticipated related to the war on terrorism and in Iraq, including for coalition building and reconstruction, as well as the skyrocketing costs of combating the HIV/AIDS pandemic, which estimates put as high as $10 billion per year. Meanwhile the budget outlook is grim and growing worse. The danger is not to the survival of the MCA (although it is far from certain that it will ever receive the full $5 billion a year the president pledged). The greater danger is that less prominent and less popular development programs will be squeezed over time from a combination of budget pressures and deterioration in the beneficiary pool, as the best performers migrate to the MCA.

## Achieving the Full Promise of the MCA

This book presents analysis and recommendations to help the MCA achieve its full promise. It is informed throughout by analogies and lessons from U.S. independent agencies, private foundations, and innovative international efforts, such as the poverty-reduction strategy papers (PRSP) process and the Global Fund to Fight AIDS, Tuberculosis, and Malaria (Global Fund). It strongly endorses many of the guiding principles of the administration's proposal and suggests concrete ways for implementing them. The MCA design should emphasize selecting countries in a transparent, objective manner on the basis of their policy environments. It should allocate funds on the basis of a competition for the best proposals, supporting country ownership of development projects from design through implementation and evaluation, and holding recipients accountable for concrete results.

The discussion below provides concrete recommendations on how best to elaborate these core elements of the MCA policy framework. The analysis shows how modest adjustments to the selection criteria and their application can result in important changes to the pool of countries competing for MCA funds and how this process can continue to be improved over time. It suggests how to strike a better balance on eligibility—not too narrow and not too broad—as well as between political discretion and objective indicators. It recommends that the MCA should have a narrow mission to support growth, poverty reduction, and sustainable development in poor nations with sound policy and good governance, by underwriting meritorious strategies designed and implemented by recipients. It advocates that MCA grants focus on a few areas of core competence, selected because of their demonstrated contribution to poverty reduction and growth and consistency with MDGs, evidence that the market alone will not ensure the socially optimal outcome, and a good track record for foreign aid. These include some but not all of the areas highlighted by the administration, such as primary education and basic health, and would add areas where the administration is out of step with the international community and many in Congress, such as the environment.

It explains in concrete terms how to implement a fundamental shift in U.S. development aid—away from the top-down, donor-driven approach to one that supports countries in designing, implementing, and evaluating plans. It suggests how to structure the grant competition so as to strengthen accountable, reformist governments while also ensuring space for civil society. In examining the operations and structure of the MCA, the book weighs the pros and cons of establishing a new agency from scratch, as opposed to creating an independent corporation within USAID, and sketches out how the latter alternative could be constructed. It also compares the proposed governance structure of the MCA with other independent agencies and recommends an alternative approach that provides for greater congressional and outside input and greater assurances of independence from political interference. And it details the instruments of operational flexibility that are most important to the MCA's central mission.

The MCA will not be accorded such operational flexibility nor succeed in breaking new ground on development aid unless Congress is a committed partner, no matter how compelling the blueprint. The MCA will be able to win trust and flexibility only if its program design contains adequate self-executing safeguards and mechanisms to ensure congressional input and oversight. Our analysis suggests a workable balance of concrete obligations and authorities.

Even if the MCA succeeds on its own terms, it may fail in making the United States a better development partner, in the absence of greater effort to ensure coherence among the many U.S. programs and agencies oriented toward development and to work with and learn from international efforts more broadly. The MCA cannot and should not go it alone in crafting development aid. One of the best-known pitfalls of foreign aid is lack of coordination among donors, which places substantial burdens on host countries and often undermines the effectiveness of assistance efforts. Recent years have witnessed an emerging, unprecedented, and important consensus at the international level about what works in poverty reduction and growth. This consensus has been made operational in a variety of new processes, agreements, and institutions. American taxpayer dollars could be greatly leveraged if they piggybacked on and learned from the efforts of the PRSP process and the Global Fund to pioneer the country ownership model that animates the MCA—underwriting development plans developed by recipient governments, with input from civil society as a central element. Similarly the MCA could rely on the MDGs as broad organizing principles, reflecting their central role in a host of mutually reinforcing international and bilateral efforts.

Likewise even a lot of money and a great idea are not enough to make a difference to U.S. foreign assistance, unless the MCA is designed to reflect the lessons from past aid failures and to enhance and complement other U.S. programs for developing countries. This is not the first time an administration has created a new agency to address U.S. foreign assistance goals. Since the inception of the Marshall Plan in 1948, successive administrations have attempted to overhaul U.S. foreign assistance programs, with responsibility—and direction—volleying back and forth between the Department of State and various independent agencies. What is different about the MCA is that it would create a new development agency without either replacing or triggering the reorganization of already existing foreign assistance programs. This has the potential to lead to bureaucratic duplication and misalignment of staff responsibilities and performance evaluation on the ground in countries that become eligible for the MCA, almost all of which already have USAID missions.

The analysis calls for articulating a clear division of labor between USAID and the MCC (whether as a new agency or as an affiliated entity) and giving greater clarity to USAID's remaining missions: to provide humanitarian assistance, support growth, sustainable development, and good governance in geopolitically important countries and in weaker-performing poor nations, and helping establish stability in failing states and postconflict situations. For those countries that nearly miss qualifying for the MCA, it is recommended that MCA funds be used under USAID's supervision to address those areas that are weak.

The MCA holds the promise of greatly increasing U.S. development assistance and pioneering a fundamentally new approach. But success is by no means guaranteed. A failed Millennium Challenge Corporation 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.