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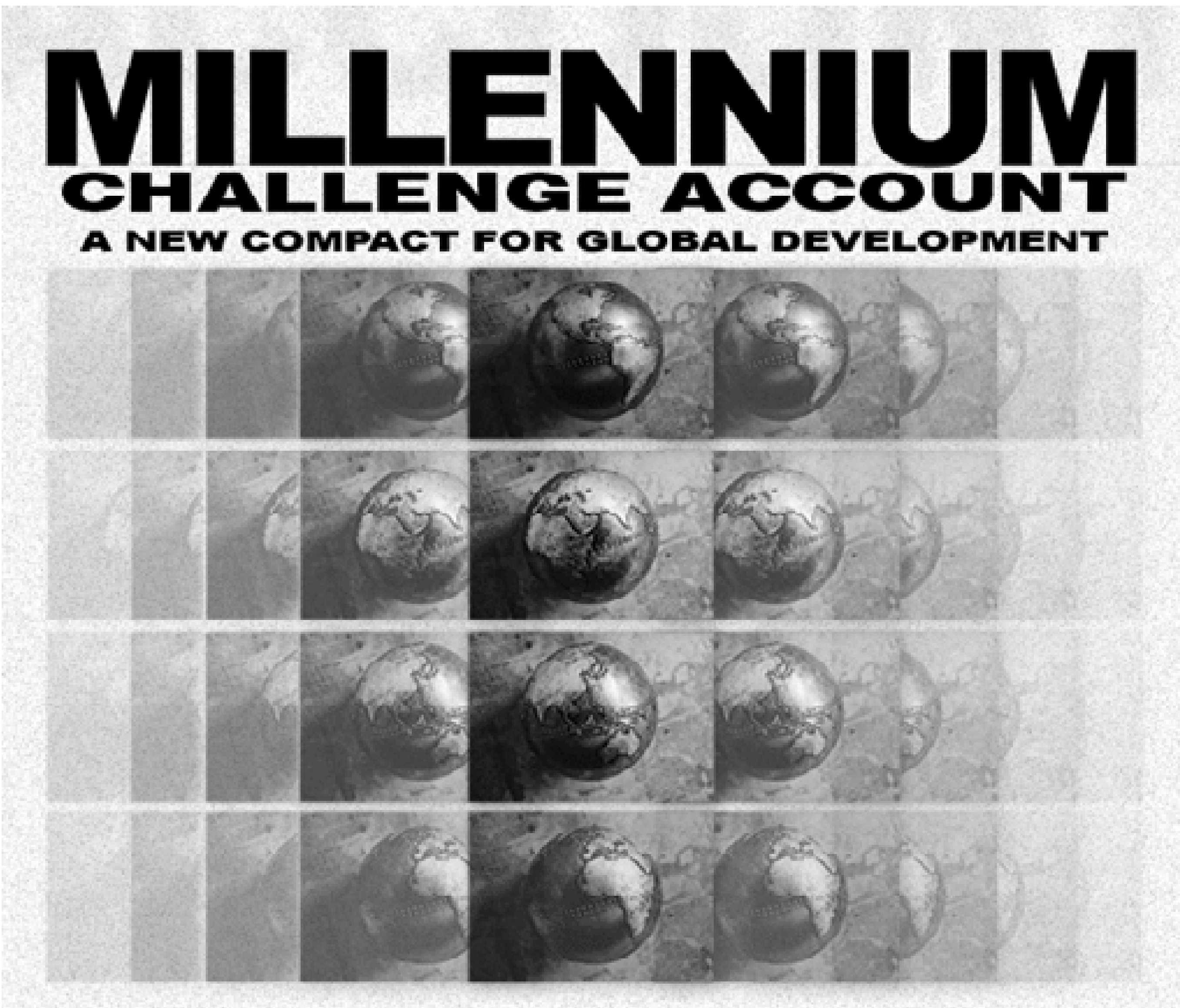

—MARCH 2003—

ECONOMIC PERSPECTIVES

MILLENNIUM CHALLENGE ACCOUNT: A NEW COMPACT FOR GLOBAL DEVELOPMENT

U.S. DEPARTMENT OF STATE *ELECTRONIC JOURNAL* *VOLUME 8, NUMBER 2*

The perils of our age should not blind us to its great promise. The United States seeks to work in partnership with other nations to build a world of hope and opportunity – a world where terrorism cannot thrive. That is why the Bush Administration has been instrumental in forging a new global consensus on how to help poor countries lift themselves out of poverty onto the road to development.

In March 2002, President Bush announced a groundbreaking development initiative – the establishment of a Millennium Challenge Account (MCA). MCA would increase core U.S. development assistance by more than 50 percent over the next three years, and the Bush Administration will work vigorously with the U.S. Congress to achieve full funding for this initiative. Full funding of MCA would result in a $5 billion annual increase in assistance over current levels by FY 2006.

MCA grants will be used to help poor countries spur the economic growth and attract the investment needed to finance their own futures. Only countries that govern justly, invest in their people, and open their economies to enterprise and entrepreneurship will qualify for MCA funds.

Under the MCA, qualifying countries will propose specific programs to address the greatest obstacles to their development. MCA grants will be awarded to governments, non-governmental organizations, and private organizations, which they will put to work promoting good governance, furthering economic reform and anti-corruption efforts, developing enterprise and the private sector, building capacity for trade and investment, raising agricultural productivity and promoting health and education. A new government corporation, whose Board of Directors I will chair, will administer the MCA to ensure that grants are used effectively.

In this journal you will find insights from key government officials and leading scholars in the development field, who see MCA as a powerful way, to use President Bush's words, "to draw whole nations into an expanding circle of opportunity and enterprise."

U.S. Secretary of State Colin L. Powell

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An Electronic Journal of the U.S. Department of State

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Editor's note: The legislative proposal President Bush submitted February 11 to Congress for the Millennium Challenge Act of 2003 now faces a lengthy process of congressional hearings and drafting of legislation before it can become law. The President's proposal will be considered by separate House and Senate committees with jurisdiction over different elements of the proposed Act. The committees will draft legislation, differences in separate House and Senate bills will be resolved between the two bodies, and a unified bill will be acted on by the full Congress and forwarded to the President for signature if he finds it acceptable. The first stage of congressional consideration began with House and Senate hearings in early March.

ECONOMIC PERSPECTIVES

An Electronic Journal of the U.S. Department of State *Volume 8, Number 2, March 2003*

The Office of International Information Programs of the U.S. Department of State provides products and services that explain U.S. policies, society, and values to foreign audiences. The Office publishes five electronic journals that examine major issues facing the United States and the international community and that provide information about U.S. society and values. The journals — *Economic Perspectives, Global Issues, Issues of Democracy, U.S. Foreign Policy Agenda, and U.S. Society and Values* — provide statements of U.S. policy together with analysis, commentary, and background information in their thematic areas.

All issues appear in English, French, Portuguese, and Spanish language versions, and selected issues also appear in Arabic and Russian. English-language issues appear at approximately one-month intervals. Translated versions normally follow the English original by two to four weeks.

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Editor, Economic Perspectives
IIP/T/ES
U.S. Department of State
301 4th St. S.W.
Washington, D.C. 20547
United States of America
E-mail: ejecon@pd.state.gov

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❑ PRINCIPLES OF GOOD GOVERNANCE

By Paula Dobriansky, Under Secretary of State for Global Affairs

"Development cannot flourish where people cannot make their voices heard, human rights are not respected, information does not flow, and civil society and the judiciary are weak," says Paula Dobriansky, Under Secretary of State for Global Affairs. Dobriansky outlines five key principles of good governance that the Bush administration will use to determine which countries will qualify for development assistance under the Millennium Challenge Account: free and fair elections; independent judiciary and the rule of law; freedom of speech and press; absence of corruption; and government investment in basic social services. These principles, she says, constitute the foundations of modern democracy and create the underpinning to establish capital markets and spur foreign and domestic investment.

In March 2002, in Monterrey, Mexico, President George W. Bush announced his goal to increase U.S. development assistance to foreign nations by 50 percent in the next three years – a $5 billion annual boost over current levels of funding – and to improve the effectiveness of this assistance. Because sound policies are an essential condition of development, the new funds will be held in a Millennium Challenge Account (MCA) and distributed to nations that, in the President's words, "govern justly, invest in their people, and encourage economic freedom." To decide which nations meet these standards, a new Millennium Challenge Corporation will use specific indicators of performance. A crucial indicator will be evidence that a country practices good and just governance.

American foreign policy has always promoted principles of good governance, and President Bush's new initiative reinforces this approach. Through monetary assistance, cooperative ventures and international dialogue, the United States has supported and encouraged nations to enact policies and form their governments so that human dignity and freedom are allowed to flourish. Some of the principles of good governance supported by the United States date back to the time of ancient Greece. Others are principles developed in more recent times, or lessons learned from the United States' own history and that of other countries.

Broadly speaking, good governance promotes fundamental and universal human rights. Because the United States believes political power lies with the people, the MCA is directed towards supporting those principles of governance that allow people to pursue their lives in a just, equitable and democratic society. We want to provide developing nations with the tools they need to educate their citizens and to take part in the opportunities offered by the global economy. We are working to eradicate corruption and create a renewed respect for human rights as well as property rights.

Perhaps the most basic and important principle of good governance is that a nation's political institutions be democratic. In the words of one of America's greatest presidents, Abraham Lincoln, democracy is a form of government "of the people, by the people, and for the people." This means that the rights and principles of democratic government can and should be universally applied. They are not a uniquely American invention. The right of every person to speak freely about his government is a basic human right, one that arises from every individual's worth as a human being, as has been recognized by nations all over the world.

FREE AND FAIR ELECTIONS

Good governance dictates that to have a functional democracy, legal safeguards and rights must exist. One of the indicators for MCA eligibility is a country's commitment to citizens' political rights. For instance, it is critical that a nation's elections be free and fair. This means that voters have a choice among candidates and that they have a right to information concerning those candidates' platforms.

Free and fair elections are open and transparent to all people without discrimination based on sex, race or ethnicity, and are unrestricted by government coercion and interference. Moreover, they create the underpinning for greater domestic investment and less capital flight. The right to free and fair elections should be guaranteed by appropriate constitutional or legal safeguards, as only with honest elections can governments be held accountable to their citizens. Voters should be able to participate freely in the political process, whether through political parties or civic organizations. Elections, however, are not the only cornerstone to democracy. Accountable leadership and fulfillment of the will of the people are essential to ensuring that elections are a means to a democratic society, not an end in themselves.

INDEPENDENT JUDICIARY AND THE RULE OF LAW

Another principle of just democratic governance is the presence of constitutional limits on the extent of government power. Such limits include periodic elections, guarantees of civil rights, and an independent judiciary, which allows citizens to seek protection of their rights and redress against government actions. These limits help make branches of government accountable to each other and to the people. Accountability is another factor that will be considered for MCA eligibility when determining whether a country practices good governance.

An independent judiciary is important for preserving the rule of law, another principle of good governance and one of the MCA criteria. It takes more than strong courts to ensure that a nation's laws are enforced constantly and fairly. All branches of government must be willingly bound by the law. The rule of law also is the basis for business formation and the establishment of capital markets, which underpin economic development. Citizens or their elected representatives should be involved in all levels of lawmaking. Participation in this process gives people a stake in the law and confidence that the law will preserve their personal and property rights.

Not only should the law be enforced, but it should also be enforced fairly and without discrimination. Good governance means equal protection for women and minorities and open and fair access to judicial and administrative systems. Political and civil rights should not be denied to citizens because of their sex, race, or ethnicity. A nation's courts should not be open to only a select few. Government agencies should allow appeals of regulations as well as citizen participation in their decision-making process, and citizens should be granted access to these bodies in a timely and easy manner.

FREEDOM OF SPEECH AND PRESS

To function properly, a just and democratic society must have a free exchange of information and ideas. This is best realized in the creation of a free and open press and the freedoms of speech and expression, which form part of the MCA's eligibility criteria of political rights and civil liberties. A free press provides voters with the information they need to make informed decisions. It facilitates the exchange of political discourse, creating a "marketplace of ideas" where no view is stifled and the best are chosen. Free press can also serve as a check on government power ensuring that public officials and institutions remain accountable to the voters. The media's ability to report on business and the economy is also important for preserving public trust in the markets and for attracting foreign and domestic investment. The right of the press to freely publish, to editorialize, to critique, and to inform is a fundamental principle of democracy.

FIGHTING CORRUPTION

Good governance also means the absence of corruption, and countries will not be eligible for MCA assistance if they are corrupt. To preserve the integrity of democracy, governments must strive to rid themselves of bribery and graft. Corruption damages economic development and reform, impedes the ability of developing countries to attract foreign investment, hinders the growth of democratic institutions, and concentrates power in the hands of a few. The best way to combat corruption is for governments to be open and transparent. While in certain cases governments have a responsibility to retain secrecy and confidentiality, democratic governments must be sensitive to the citizen's right to know. Strong laws against corruption and the presence of law enforcement agencies that work against corruption demonstrate a government's commitment to this principle.

INVESTING IN PEOPLE

Finally, good governance requires that governments invest in their people and work to preserve the welfare of their citizens, without regard to gender, race or ethnicity. Governments should devote resources to health care, education, and combating poverty. They should strive to create an economic environment where people can find jobs and establish businesses. Along with other measures, a government's ability to provide for its people is considered by the MCA in determining governmental effectiveness. Governments also have a duty to protect their citizens from criminal violence, especially the practice of trafficking of persons. Women and girls are most vulnerable to this illegal trade, which can only be stopped by diligent law enforcement.

CONCLUSION

Practicing these principles of good and just governance results in a free and open society where people can pursue their hopes and dreams. This will facilitate the creation of robust and open economies, which are trusted by investors and financial institutions. Development cannot flourish where people cannot make their voices heard, human rights are not respected, information does not flow, and civil society and the judiciary are weak. The United Nations Development Program (UNDP) and the World Bank, among others, have come to realize that development assistance that focuses only on economic governance at the expense of democratic governance fails. The proof is in the numbers: 42 of the 49 high human development countries on the UN *Development Index* are democracies. With just two exceptions, all of the world's richest countries have the world's most democratic regimes.

It is America's hope that by promoting good governance in our foreign policy, particularly through the MCA, the condition of citizens' lives worldwide will be enhanced through the creation of strong democratic nations with prosperous economies and improved standards of living.

Americans have a deep appreciation for the freedoms and opportunities they enjoy and believe the principles that underlie our democratic institutions and vibrant civil society are the best way to achieve sustainable economic growth. The President's MCA initiative marries the commitment of developing nations that govern justly with the commitment of the United States to support their reform efforts and to help fulfill the dreams of freedom-loving people throughout the world. ❑

❑ THE MCA PROMOTES SOUND ECONOMIC POLICIES

By E. Anthony Wayne, Assistant Secretary Of State for Economic and Business Affairs

Development does not just "happen"; it requires economic growth that occurs when people and governments respond to economic incentives, says E. Anthony Wayne, Assistant Secretary of State for Economic and Business Affairs. "But throwing money at problems without the foundation of sound government policies will not have lasting impact on people's lives," he says. That is why the Millennium Challenge Account (MCA) intends to promote and reward economic policies that work – sound macroeconomic governance, an efficient regulatory system, an open trade regime and a healthy climate for business investment.

Wayne says economic freedom created by these policies is essential for mobilizing domestic assets and encouraging entrepreneurship, as well as boosting trade and attracting foreign investment. He cites agriculture as one of the areas where the MCA could have a higher return in countries that are committed to economic freedom. But the MCA initiative will succeed only if the United States selects countries really committed to pursuing pro-growth policies and addressing the main bottlenecks to development, he says.

In announcing the Millennium Challenge Account (MCA) initiative last March, President Bush reconfirmed the commitment of the United States to bring hope and opportunity to the world's poorest people and called for a new compact for development defined by greater accountability for rich and poor nations alike. To fulfill our part of the compact the United States, with congressional approval, will increase its core development assistance by $5 billion through the MCA – an increase of 50 percent – over the next three years. The President has submitted this new program to Congress for its authorization and appropriation of funds. These funds, the President said, will be "devoted to projects in nations that govern justly, invest in their people, and encourage economic freedom."

Aptly named, this initiative challenges developed and developing countries to work together as real partners to establish a new results-based paradigm for economic development. It aims to tackle one of the most vexing problems of our times – how to support lasting improvements in living standards and reduce poverty in the poorest nations of the developing world.

PROVIDING INCENTIVES AND SEEKING RESULTS

Development doesn't just "happen," no matter how much money you throw at it. From over 30 years of experience in attempting to spur development growth abroad, we have learned several simple lessons. Development requires economic growth. Economic growth occurs when people and their governments respond to economic incentives. Money is an incentive, certainly. But throwing money at problems without the foundation of sound government policies will not have lasting impact on people's lives. Government mismanagement or outright corruption is an even greater disincentive to development, thwarting the fundamental entrepreneurial spirits of citizens and businesses alike. President Bush's Millennium Challenge Account puts incentives in place to encourage policies that work: first by setting policy- and commitment-based eligibility requirements to qualify for the MCA program; second by providing additional funds; and third by insisting that MCA programs show results by meeting mutually agreed benchmarks and development objectives.

We know that aid alone cannot lead to sustainable economic growth. Most of the developing world already possesses substantial assets that could be mobilized to promote their economic development. For a country to build on its wealth, however, that wealth must stay at home. For this to happen, countries must attract capital and put in place economic incentives to discourage capital flight. Estimates of sub-Saharan African country external assets, for example, exceed the stock of their external debt – a sure indication of capital flight. The MCA will promote a sound investment climate that can help pull some of this capital back into Africa.

Trade and investment flows dwarf the MCA's $5 billion and the $50 billion given by all donors in official development assistance each year. Developing countries exported close to $2 trillion in goods and services in 2001. Foreign investment flows to and among developing countries amount to $180-200 billion annually. And, of course, the biggest source of capital are the hardworking people of developing countries themselves, who produce goods and services valued at over $6 trillion dollars each year and savings amounting to over $1 trillion. The MCA will provide incentives and practical support to promote the sound economic policies and build the capacity that developing countries need to tap productively these far greater sources of development finance.

ENCOURAGING ECONOMIC FREEDOM

The link between development progress and governments that support freer markets, individual liberties, and effective institutions is robust. Sustainable development also takes hold when good governance is joined with a dynamic private sector. A vibrant private sector gives free reign to human creativity, fostering innovation and improving the living standard of everyday people. The most vital resources a country possesses are the skills and entrepreneurial spirit of its citizens. Unfortunately, domestic economic resources and capital have all too often been squandered, sometimes by conflict, but also by economic policies that do not give individual families and firms the proper incentives to save and invest in their future, and to innovate and engage in productive enterprise.

To qualify for the MCA, each MCA candidate will need to encourage economic freedom through good macroeconomic governance, an efficient regulatory system, an open trade regime, and a healthy climate for business investment. The MCA will then help qualifying countries boost their economic growth by providing grants to productivity-enhancing areas such as agricultural development and private enterprise, building trade and investment capacity, and investing in health and education.

Good Macroeconomic Governance: Governments help set the stage for lasting economic development through their macroeconomic policies. The MCA recognizes this and assesses potential MCA countries on two indicators of macroeconomic health. It will give credit to countries whose inflation rate, based on IMF data, is less than 20 percent and whose three-year budget deficit is less than most other peer countries.

MCA recipient countries provide a supportive economic environment for their private sectors with prudent monetary and fiscal policies. Prudence in these areas reduces currency risk, helps attract foreign investment, and allows domestic enterprises to make long-term investments. There are few examples of long-term economic development by countries with persistent high inflation while there are many examples of economies falling prey to hyperinflation. Inflation disproportionately hurts the poor, who are less able to protect their assets. In addition, the uncertainty caused by inflation discourages long-term financial contracts. These dangers argue for great care on the part of monetary authorities in the creation of domestic credit and printing of money to avoid soaring interest rates and flight of the capital so necessary for development.

Sound fiscal policy management is also an essential part of an enabling environment that promotes income and job-creating economic activity of all types. The fundamental elements of good fiscal governance reflect transparency and accountability. They begin with the honest administration of public funds through a transparent budget process – expenditures must be subject to public audit and accountability. Government deficits can lead to higher interest rates, which “crowd out” private sector investment projects. Furthermore, high deficits often lead developing governments to pressure financial institutions to buy government debt, which can erode the stability of the financial system. Government policies are pro-growth when they have limited control of the economy and let the free market flourish in playing its essential role in signaling how to allocate resources.

A Fair and Transparent Regulatory System: The MCA will compare the regulatory environment for business in MCA candidate countries by looking to the World Bank Institute's indicator of Regulatory Quality. An overly onerous regulatory system, especially one that is exercised arbitrarily, can encourage corruption. Furthermore, this can encourage firms to stay small to avoid regulation, reducing their ability to take advantage of economies of scale and eroding the tax base of the country. While an effective and fair regulatory regime is essential, the MCA encourages countries to limit regulation and government intervention that can damage prospects for economic growth. New business ventures flourish when only days, not months, are needed to obtain necessary approvals from government regulatory agencies. That is why the MCA will consult the simple indicator from the World Bank of “Days to Start a Business,” which is also an indicator of efficiency of regulation and commitment to economic freedoms.

An Open Trade Regime: Experience shows that opening markets and expanding trade and investment can accelerate growth. Open markets and access to trade unleash creativity and know-how, multiply economic opportunities, and generate self-sustaining growth and investment cycles. Trade has helped nations as diverse as Singapore and Chile create economic opportunities for millions of their citizens. The MCA looks to the Heritage Foundation's Trade Policy Index to measure a country's trade openness.

The entrepreneurial spirit, when exposed to the world's free market, is not limited by geography, but rather soars in innovation, setting the path for economic growth and poverty alleviation. We have seen that very poor countries can use trade as a platform to progress. Many countries, however, have yet to reap the full benefits of free trade. Although low- and middle-income countries exported close to $2 trillion last year, further trade liberalization would dramatically increase their exports, and hence their growth prospects.

The Doha Development Round, taking place under the auspices of the World Trade Organization, aims to bring down trade barriers worldwide and will create for developing countries vast new opportunities to trade with each other and with developed economies. A central focus of the Doha Round is to work with the countries of the developing world to ensure that they are able to fully participate in the global trading system to expand their trade in agricultural goods in order to round out their diets and alleviate famine. The United States stands as a strong trade leader, exporting and importing over $450 billion in products from the developing world every year. That is more than eight times the amount these countries receive in aid from all sources. We will work with MCA recipient governments to increase their openness to trade, seize additional trade opportunities, and gain the growth benefits.

A Healthy Climate for Business Investment: Productive investment is essential for development. MCA development funds will flow toward countries that create a positive business environment for domestic and foreign investment. Since foreign direct investment not only brings capital but can also bring skilled management, new technology, good environmental practices, and knowledge of foreign markets, it is an especially prized development vehicle. Research evidence shows that where good governance and sound economic policies are in place, each dollar of foreign aid invested attracts two dollars of private investment. For business ventures – whether foreign, domestic or joint venture in origin – to be viable, the regulatory environment established by the host government must be conducive to their profitable operation.

There are ample incentives for foreign and domestic business to invest in developing countries. The developing world's markets are growing and their workforce is underutilized and inexpensive. While investment is by its very nature risky, investors prefer that their exposure is limited to normal business risk. They therefore prefer investing in countries whose governments protect against expropriation and ensure that the economic returns from investments may be freely repatriated. The MCA will look at the country credit rating prepared by *Institutional Investor* magazine to assess the attractiveness of potential MCA countries to investors.

RULE OF LAW AND THE PROMOTION OF ECONOMIC GROWTH

While the rule of law is an essential and measurable MCA indicator of governing justly, it also has a profound influence on a country's economic freedom. Sound, predictable and transparent legal systems must exist to provide the foundation for business confidence and the protection of property rights. In Egypt, notes Peruvian economist Hernando de Soto, the wealth that their poor have accumulated is worth fifty-five times as much as the sum of all direct foreign investment ever recorded there, including the Suez Canal and the Aswan Dam. Reliable legal systems are essential to harness the power of such wealth and to bring to life so-called "dead capital" – the assets of the poor that so often cannot be formally recognized or leveraged to build or expand enterprises.

Enhancing corporate governance and building supportive legal institutions are vital to gaining the trust of a country's citizens in their government and in their economic future. Being assured of the formal recognition of businesses and legal ownership of property, for example, citizens then have incentives to expand both. Advanced technologies and business practices brought into the production process of the developing world can spur employment, eliminate poverty, and bring significant profit incentives to all partners in the joint ventures. These technologies and practices are proprietary to the businesses bringing them, however, and their intellectual property rights must be guaranteed and legally protected by developing country governments. The aim is to promote systems that protect all property owners, whether large or small, domestic or foreign.

ONE POTENTIAL AREA FOR MCA FUNDING

Agriculture is one of the potential areas for MCA funding, and investments in this sector could have a higher return in countries that are committed to economic freedom. Agriculture has great potential for spurring economic development. Roughly 3 billion people live in rural areas, 1.3 billion of them on what the World Bank calls "fragile lands." In Africa, over 70 percent of people work in agriculture. Worldwide, over 800 million are malnourished. Increasing agricultural productivity in developing countries can lift many in rural areas out of poverty and abolish famine. Huge technological advances have been made in agriculture over the last several decades. By bringing this knowledge to those who most need it, developing countries can embark on the road to food self-sufficiency and rural populations can enter the cash economy.

Developing country governments, however, have to be open to and supportive of new technology. Working cooperatively with governments of MCA countries, MCA funds could be used to develop integrated agricultural programs that could educate local farm communities on how to increase agricultural productivity, provide incentives to develop distribution channels, and develop needed infrastructure. Bangladesh is just one success story, having increased its rice production by nearly 70 percent since the 1970s by employing advanced agricultural methods and technology.

ACHIEVING DEVELOPMENT

President Bush concluded his announcement of the Millennium Challenge Account initiative with a typical Americanism: "The bottom line for us, and for our developing country partners, is how much development they are achieving." The MCA initiative will only succeed if we select partners that have put in place the policies that allow growth to take place, undertake programs that address the key bottlenecks to development, and hold to the agreed benchmarks that measure progress toward achieving agreed objectives. By requiring these policies in order to qualify for MCA funds and tracking the funds through successful development programs, the Millennium Challenge Account will promote incentives for sound economic policies that will result in economic growth and prosperity in the countries that join us in rising to the challenge. ❏

❑ HEALTH AND EDUCATION KEY TO NEW FOREIGN AID PLAN

By Andrew Natsios, Administrator, U.S. Agency for International Development

A country cannot truly live up to its potential nor can its people reach a decent standard of living without improving its public health and education, says Andrew Natsios, head of the U.S. Agency for International Development (USAID). Natsios argues that without investment in the social sector, governments are unlikely to experience the multiplier effect education has on economic growth, health, democracy and governance.

He warns that investments in the health sector are essential to reduce the risk of social and economic disruptions that can result when HIV/AIDS and other infectious diseases reach the scale of pandemics. The Millennium Challenge Account (MCA) can help countries committed to good primary education and public health go beyond basic goals and build upon their success in these areas to drive up productivity and economic growth, he says.

The Millennium Challenge Account (MCA) that President Bush announced in March 2002 will add $5 billion a year to U.S. foreign aid but will require countries to show they are improving the health and education of their own people before getting MCA assistance.

To reduce global poverty through economic growth, the MCA will "reward nations that root out corruption, respect human rights and adhere to the rule of law . . . invest in better healthcare, better schools and broader immunization . . . and have more open markets and sustainable budget policies," Bush said.

The 50 percent increase in overall U.S. foreign aid that the MCA will bring is based on the foundation of good governance – commitments of honest governments to rule justly and protect the liberty and property of the people.

The investment in social programs – from primary education to vaccination – that the President set as a benchmark countries need to meet to obtain MCA aid is far more critical to economic development than it might at first appear.

Even if correct economic strategies are in place – stable currency, balanced national budget, market economy – and there is good infrastructure for production and trade – roads, electricity, ports, telecommunications – a country cannot truly live up to its potential nor can its people reach a standard of living considered acceptable for modern times without improving the health and education of its people.

For this reason, the Millennium Challenge Corporation (MCC) created to administer the MCA will measure each applicant country to be sure it is working on behalf of the health and education of its people. In too many countries, this has not been the case.

The Millennium Challenge Account is meant to be a tool or instrument in the hands of reformers in any country where powerful oligarchic interests and corruption block change. This puts an arrow in the quiver of the reformers.

Political and economic reform is what's needed before a country takes off and reaches a new level of growth.

For years we Americans have argued about foreign aid. Some said it was a waste of taxpayer money. Others said corrupt governments grabbed the lion's share of the aid. And still others said we needed to do more for millions of needy people overseas. President Ronald Reagan stressed the need to teach people how to earn their own living rather than supply them with humanitarian aid as a permanent entitlement.

The current state of the world – with anti-Western sentiment in the Islamic world and the spreading HIV/AIDS pandemic in Africa and elsewhere – makes these arguments of the 1990s about whether to extend foreign aid seem out of date.

Development assistance now takes its place alongside defense and diplomacy as one of the three essential components of American foreign policy, according to President Bush's National Security Strategy.

The administration has made a new commitment to see that aid is truly effective and helps lead developing countries towards improving their own public health, education, nutrition and other basics that modern humanity has come to expect as its universal birthright.

“The goal of the MCA is to reduce poverty by significantly increasing the economic growth trajectory of recipient countries,” according to a White House February 5, 2003, background paper.

“This requires an emphasis on investment that raises the productive potential of a country's citizens and firms.”

Education is especially important because of the multiplier effect it has – beyond literacy – on economic growth, democracy and good governance. A woman with a sixth-grade education will produce more food with no additional inputs or skills.

Education helps people cast an informed ballot.

And educated women have fewer children while the children they do bear have a greater chance of survival.

Health is vital if people are to escape from poverty. In many developing countries, millions are ill with recurring bouts of malaria that sap their ability to work at jobs or produce the very food they and their families need to survive. Similarly, the HIV/AIDS pandemic has infected 60 million people, and so many farmers, teachers and other necessary workers are ill or dying in parts of Southern Africa that several countries are at risk of massive economic and social failure.

USAID has long been involved in helping countries improve their health and education and is ready to assist countries that wish to qualify for MCA funds.

Countries eligible for MCA funding will be identified by 16 indicators that will be used to assess national performance. The 16 are divided into three groups: governing justly, promoting economic freedom and investing in people.

To determine how countries are performing in these areas, the MCC will examine reports by prominent institutions such as the World Bank, the International Monetary Fund, the Heritage Foundation and Freedom House. The four indicators that a country is investing in the health and education of its people will be determined by using the World Bank and national sources. Those four are:

- **Public primary education spending as a percent of gross domestic product (GDP).**

Literacy is critically important for development. It allows mothers to read and understand directions on medicine bottles and food packages; it allows workers to tackle higher-paying jobs; it enables people to learn about health risks and business opportunities through newspapers and flyers. Some low-income countries spend a lot on education, but much of that goes to sending the children of the elite to university for free, instead of giving primary education to all – a priority for obtaining MCA funds.

- **Primary education completion rate.**

Even if money is allocated for primary education, this does not guarantee an educated population. Corruption, poor quality of teaching, child labor and barring girls from school or religious education may leave many children too poorly educated to participate in development. Therefore the completion rate will be a factor in MCA eligibility.

- **Public expenditures on health as a percent of GDP.**

It is no longer acceptable that only people living in wealthy countries or the elites in the developing world have access to medicine and treatments that ease pain, prolong life and enable us to live healthier, more productive lives. Unless countries show they are allocating funds to fight malaria, tuberculosis, diarrhea and other illnesses that sap the productive strength of a people, MCA funds will not be available.

- **Immunization rates for diphtheria, pertussis, tetanus and measles.**

Even if a country allocates sufficient funds to health, they may be tilted towards costly MRI machines and other equipment or treatments that serve the elite in the cities rather than the basic health needs of the rural and urban poor. Vaccination rates will reveal whether they are reaching the poor majority.

To be eligible for MCA funding, a country must show it is performing on two of the four social investment criteria listed above. In addition, each country must perform adequately on three of the six criteria for governing justly and promoting economic freedom.

Once a country meets those criteria, the final decision on eligibility will be made by the MCC board, which will be chaired by the Secretary of State and include the Secretary of the Treasury and Director of the Office of Management and Budget. The chief executive officer of the corporation will be confirmed by the Senate.

In the past, countries received foreign aid based on need. About 15 percent of that assistance went through governments and the rest through non-government organizations, universities, cooperatives, trade associations, professional associations and faith-based groups and businesses.

Such aid – including humanitarian relief in the case of natural and man-made disasters – will continue through USAID and other U.S. government agencies. However, the MCA asks applicant nations, "What have you done for your own people?" before inviting countries to participate.

If a government is putting children through primary school, then MCA can help do something about providing graduates with jobs or help create secondary school systems.

Each selected country will sign a contract with the MCC that provides for financial accountability of MCA funds and includes a limited number of clear and measurable objectives as well as regular benchmarks to measure progress.

In order to drive up productivity and economic growth, MCA will focus on a few key areas: agriculture, education, private enterprise, private sector promotion, good governance, health and trade and investment.

MCA rules and funding are part of the Millennium Challenge Act of 2003, which awaits congressional approval. It authorizes $1.3 billion in fiscal year (FY) 2004 with spending going up until FY 2006 when the full $5 billion per year will be budgeted.

Since the MCC will only have a staff of 100 – some of whom will likely be USAID staff and experts assigned to the new body – MCA aid will be carried out and monitored by a variety of actors, including USAID staff and missions overseas, non-governmental organizations, faith-based relief groups and others.

President Bush said in his National Security Strategy (NSS) that U.S. assistance to poor countries remains a basic part of foreign policy because of America's ethical values as well as U.S. national interest in preventing states from failing. Poverty and despair abroad often return to America in the form of disease, drugs, illegal migration, and the loss of the common environment of the planet.

"Finally, the United States will use this moment of opportunity to extend the benefits of freedom across the globe," the NSS says. "We will actively work to bring the hope of democracy, development, free markets, and free trade to every corner of the world."

The MCA is the biggest increase in American foreign aid in perhaps 40 years. ❑

❑ ANTI-CORRUPTION: UNSHACKLING ECONOMIC DEVELOPMENT

By Nancy Zucker Boswell, Managing Director, Transparency International (TI) USA, and Peter Richardson, adviser to TI's international secretariat

Corruption saps a country's economy by hampering tax collection, wasting resources, deterring private investment, discouraging entrepreneurship and undermining the enforcement of important regulations, says Peter Richardson, an adviser to Transparency International (TI) and former director of Transparency International USA, the U.S. chapter of the nongovernmental organization dedicated to combating corruption. He says it also disproportionately harms the poor because it skews economic planning against investments in social services.

"The Millennium Challenge Account (MCA) eligibility requirement of a demonstrated commitment to limit corruption and promote good governance can be a major step toward changing the incentive system for development assistance," says Nancy Zucker Boswell, TI-USA's managing director. "It will send an important signal that there will be added costs to not addressing corruption – ineligibility for MCA assistance." Boswell and Richardson argue that the policy changes should start with preventive measures such as reforming civil service, where needed, and ensuring transparency of all laws and regulations. They add that countries need to implement a criminal law system where there are "independent prosecutors to bring cases and a competent and independent judiciary to impose sentences."

There is a global consensus that corruption in government and business inhibits economic growth and can perpetuate poverty. Because financial resources are fungible and corruption drains them, economic assistance to countries that have not demonstrated a commitment to reducing corruption is unlikely to lead to sustainable development. This conclusion has led bilateral and multilateral development assistance agencies to reconsider the criteria for aid recipients and to move toward a greater emphasis on good governance.

According to the legislation transmitted recently by the Bush administration to Congress, to merit help from the proposed Millennium Challenge Account (MCA) countries must show by their actions that they are serious about reducing corruption. Such a "demonstrated commitment" is necessary to establish that countries have the requisite determination to spur their own economic development and poverty reduction and to ensure that the intended benefits of such economic assistance will not be dissipated.

CORRUPTION IMPAIRS DEVELOPMENT

Efforts to quantify the economic loss due to corruption are necessarily speculative, but numerous independent estimates have been made. In an estimate by the World Bank, which the Organization for Economic Cooperation and Development (OECD) considers conservative, the annual cost of corruption was calculated at more than $80 billion worldwide – more than the total of all economic assistance. Research at the International Monetary Fund has indicated that corruption can reduce a country's growth rate by 0.5 percentage point per year. A former senior World Bank procurement expert estimates that corruption commonly adds 25 percent to the cost of large government contracts.

Large bribes sap a country's economy, and small bribes – for example, "facilitation" payments to speed up routine government actions – disproportionately harm the poor. Corruption tends to bias country economic planning against the social sectors, which tend to be most beneficial to the very poor, and in favor of large capital-intensive projects, which present more opportunities for large corrupt "rake-offs."

It also undermines economic development and poverty reduction in numerous, diverse, and often immeasurable ways. For example, where corruption is pervasive it deters the best people from entering government service, making corruption self-sustaining; and it provides an incentive for those who have joined the civil service to pursue personal enrichment rather than the public good. This reduces respect for the law, can facilitate crime, and generates cynicism, which feeds the expectation that extortion is inevitable and bribery necessary. Equally important, corruption undermines the enforcement of important regulations, such as building safety codes and environmental protections, and provides an incentive for the proliferation of unnecessary regulatory requirements, each of which creates opportunities to extort bribes.

Tax collection becomes more difficult in highly corrupt environments, making higher tax rates a necessity to obtain required revenue. This can create an incentive for capital flight.

Pervasive corruption can erode political stability, deterring private foreign and domestic investment. Even where stability is not a factor, the high likelihood of extortion discourages such investment.

While correlation does not necessarily indicate causation, it is significant that quantitative analyses have shown that corruption correlates positively with policy distortion and the time business must spend with government officials. It correlates negatively with merit-based recruitment in civil service, civil service wages, predictability of the judiciary, foreign direct investment, the ratio of gross investment to gross domestic product (GDP), women's rights, investment in education, and national environmental performance.

Corruption is not the sole cause of countries' persistent poverty. Poor natural resource endowments, poor economic management, poor education systems, inadequate infrastructure, poor incentives for farmers and businesses, poor administration, and the shortage of savings and capital for investment (to name a few) often contribute. But large-scale corruption invariably impairs development.

WHAT CAN BE DONE ABOUT IT?

While it is unlikely to be totally eliminated, large-scale or pervasive corruption is not inevitable in any country. Movements over time in country rankings on the *Transparency International Corruption Perception Index*, which ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians, illustrate that corruption can be tackled.

Given the scope of the problem, a holistic approach and a long-term perspective to anti-corruption reform are essential. Making such an approach operational requires leaders with the political will and a broad mandate from civil society, including the private sector. The participation of all these stakeholders – government, civil society, and the private sector – is essential.
Within many countries, these groups have worked in coalition to list major weaknesses and gaps in the country's "integrity system." They have set priorities, identified targets of opportunity, built sustained political pressure, and monitored the progress of reform.

Diverse conditions, which exist from one country to another, make it impossible to prescribe a universally applicable menu of necessary reforms or any standard sequence for introducing them. Nevertheless, the most urgent reform starts with instituting preventive measures. They are usually more cost effective and less divisive than focusing solely on criminal laws, detection, and prosecution, although the measures anchored in criminal laws can have a long-term deterrent effect when done with persistence and on a large scale.

The most critical preventive measure is for the public sector to undertake to publish in a prompt and accessible manner all laws, regulations, administrative and judicial decisions, procurement, campaign finance, and other routine information. It should provide opportunities for public participation and transparency in the decision-making process before actions are taken.

Preventive measures should also include instituting codes of conduct and conflict-of-interest standards for public officials, with training to promote compliance and sanctions for non-compliance. Higher-ranking officials should publicly disclose their assets on a periodic basis in order to minimize opportunities for illicit enrichment. Whistleblowers and the media must be protected from reprisal so they can play a responsible role.

Beyond the preventive measures, there is a role for criminal law provided there are independent prosecutors to bring cases and a competent and independent judiciary to impose sentences. It is this area that citizens find particularly problematic, given the prevalence of impunity, weak institutional oversight, and lack of respect for the rule of law. The practical effectiveness of recent multilateral conventions that prescribe preventive and criminal measures, including the InterAmerican Convention Against Corruption and the Council of Europe Criminal Law Convention on Corruption, will depend on how these issues are addressed.

Additional public sector reforms often needed will also include: civil service reform, particularly providing compensation that permits a reasonable standard of living; regulatory reform to reduce the number of approvals required and the scope for official discretion in granting them; and strict rules, broad publication and public oversight to promote transparency and accountability in public-sector procurement.

No anti-corruption strategy will be successful without the participation of the private sector. Domestic and multinational corporations should adopt and apply codes of conduct and procedures to promote ethical conduct and to monitor compliance with laws and regulations, including those prohibiting domestic and transnational bribery. Since the entry into force of the OECD Convention on Bribery of Foreign Public Officials, there are criminal prohibitions on transnational bribery. While enforcement of these and related domestic laws will be the prerequisite to changing corporate behavior, corporations are well advised to institute programs that include training, procedures for reporting illegal or unethical behavior, and strong monitoring and enforcement mechanisms. Companies should establish and maintain an effective system of internal controls, books, and records that accurately reflect their transactions and disposition of assets. As a general matter, all professionals, such as accountants, auditors and attorneys, should have and enforce standards and codes of ethics and an effective accreditation process.

Obviously, carrying out such an ambitious range of reforms can be complex and will require a long-term commitment. It will require technical and financial capacity and, above all, political will. The public plays a key role in keeping the subject high on the political agenda. Rankings, such as the annual *Transparency International Corruption Perception Index,* which builds pressure for reform, and "service delivery surveys," which gauge the incidence of bribery in individual government agencies, enable reform efforts to be directed to the areas of greatest need. Other useful surveys include those that assess agency budgetary inputs in relation to outputs and "Big Mac" surveys, which compare the cost of similar items such as aspirins in various public hospitals to identify unjustified divergence.

Bilateral and multilateral development assistance agencies, in designing their assistance strategies, must also play a key role. Mainstreaming anti-corruption into country assistance strategies will help reformers. The institution of systems for investigating allegations of corruption in procurement and for debarring firms found to have engaged in corruption is another step forward. Multilateral development banks could do more, including adding as a condition for bidding a requirement that bidders have anti-bribery codes of conduct and compliance programs.

CONCLUSION

The MCA eligibility requirement for a demonstrated commitment to limit corruption and promote good governance will be a major step towards changing the incentive system for development assistance. It will add to the already enormous costs of corruption for those who fail to meet these criteria. Donors must consider how the needs of these countries will be addressed. In those that do meet the requirement, MCA assistance can help promote reform because it requires governments, businesses, and civil society to work together in a constructive partnership. In so doing, it has the potential to improve the prospects for economic development and the productive use of assistance. Realizing this potential will require field-based assessments of the state of corruption in a country and the effectiveness of MCA projects, and careful attention to auditing and accountability to ensure that funds are used as intended. This will be a huge challenge but one that promises to have a profound impact on future assistance strategies and their success in combating corruption. ❏

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

❑ PROMOTING GROWTH AND PROSPERITY IN THE DEVELOPING WORLD THROUGH ECONOMIC FREEDOM

By Brett D. Schaefer, Jay Kingham Fellow in International Regulatory Affairs, The Heritage Foundation

The past 50 years of bilateral and multilateral development assistance suggests that increased aid funding without fundamental economic, social and political reforms in poor countries will be ineffective and possibly counterproductive, says economist Brett D. Schaefer. Open markets, support for entrepreneurial activity and adherence to the rule of law are among those key policy reforms that can provide the most reliable path to increased economic growth and prosperity for those countries, he says. Schaefer argues that the Millennium Challenge Account seeks to achieve a "fundamental revolution" in development assistance not only by linking aid to policies that have proven complementary and conducive to economic growth, but also by recognizing that reforms must be crafted and enforced by the aid recipients and not the donor countries.

For over 50 years, developed nations have spent hundreds of billions of dollars in multilateral and bilateral assistance trying to help poor countries develop. The record of this effort is very disappointing. Aid has more often been ineffective or counterproductive than it has achieved its intended goal of spurring economic growth and development. As a result, poverty remains among the world's most pressing problems, and many recipients of development assistance are today as poor or poorer than they were decades ago.

To many governments and non-governmental organizations, this failing is due in large part to insufficient development assistance. For instance, after President Bush's pledge to increase the United States' development assistance budget by $5 billion annually through the Millennium Challenge Account, the Center for Global Development and the Center on Budget and Policy Priorities criticized:

"The level of spending proposed by the Bush Administration … would still leave aid spending as a share of all government spending and as a share of the economy well below its historical averages."

But the failure of development assistance is not due to a lack of resources. For instance, Organization for Economic Cooperation and Development (OECD) data show that between 1980 and 2000 the United States alone gave over $144 billion (in constant 1999 U.S. dollars) in official development assistance to 97 countries, regions, and territories for which per capita gross domestic product (GDP) data from 1980 to 2000 are available.[1]

These 97 countries had a median inflation-adjusted per capita GDP of $1,076 in 1980 but only $994 in 2000, a decline in real terms.

Compound annual growth in per capita GDP for these countries averaged -0.16 percent, with 12 experiencing negative growth and only four achieving growth over 1 percent.

Clearly, development assistance did not uniformly or frequently lead to strong economic growth. As noted by former World Bank economist William Easterly in his article "The Cartel of Good Intentions," "as many aid-receiving low-income countries had negative per capita growth as positive.... Among all low-income countries, there is not a clear relationship between aid and growth." What is clear from this experience is that simply increasing investment through foreign assistance will not promote growth and prosperity in developing countries.

THE PATH TO GROWTH AND PROSPERITY

Economic studies, conceding that the level of aid is not the central issue, have focused on what policies are most conducive to economic growth and development. In its *1996 World Development Report: From Plan to Market,* the World Bank observed:

"The state-dominated economic systems of [developing and former communist] countries, weighted down by bureaucratic control and inefficiency, largely prevented markets from functioning and were therefore incapable of sustaining improvements in human welfare."

Subsequent World Bank studies have demonstrated that open markets and economic liberalization provide the fastest, most reliable path to increased growth and prosperity. A 2002 World Bank study titled *Globalization, Growth, and Poverty: Building an Inclusive World Economy* found that increased globalization (defined as trade as a percentage of GDP) from the late 1970s to the late 1990s led to higher economic growth. The more globalized developing countries (24 developing countries with over 3 billion people) achieved average growth in income per capita of 5 percent per year in the 1990s. By contrast, in less globalized developing countries "aggregate growth rate was actually negative in the 1990s." The losers in the age of globalization are the countries that refuse to embrace economic liberalization and the global market.

Contrary to the claims often raised by anti-globalization activists, World Bank analysis found that globalization helps the poor as much as the rich and improves labor and environmental standards in the long run. A June 2001 World Bank study titled *Trade, Growth, and Poverty* found that increased growth resulting from "expanded trade leads to proportionate increases in incomes of the poor … globalization leads to faster growth and poverty reduction in poor countries." *Globalization, Growth, and Poverty* found that while wages may dip in the short term after liberalization, "in the long run workers gain from integration. Wages have grown twice as fast in the more globalized developing countries than in the less globalized ones, and faster than in rich countries as well." Similarly, "despite widespread fears, there is no evidence of a decline in environmental standards. In fact, a recent study of air quality in major industrial centers of the new globalizers found that it had improved significantly in all of them."

The *Index of Economic Freedom*, published annually by the Heritage Foundation and the *Wall Street Journal*, confirms these studies. The *Index* grades 10 factors for 161 countries with 1 being the best score and 5 being the worst score. These factors are: trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and black market activity. Those 10 scores for these factors are then averaged to give an overall score for economic freedom. Countries are designated "free," "mostly free, " "mostly unfree," and "repressed" based on these overall scores.

As shown in the *Index*, free countries on average have a per capita income twice that of mostly free countries, and mostly free countries have a per capita income more than three times that of mostly unfree and repressed countries. This relationship exists because countries maintaining policies that promote economic freedom provide an environment that facilitates trade and encourages entrepreneurial activity, which in turn generates economic growth.

Analysis by economists Richard Roll of University of California Los Angeles and John Talbott of the Global Development Group supports the conclusion that the path to increased growth and prosperity is for countries to adopt policies that promote economic freedom and the rule of law as measured by the *Index*. Their work demonstrates that the economic, legal, and political institutions of a country explain more than 80 percent of the international variation in real income per capita between 1995 and 1999 in more than 130 countries. Civil liberties, government expenditures, political rights, press freedom, and strong property rights had the most consistent, positive influence on a country's per capita income. The variables having a negative effect on per capita income included black market activity, excessive regulation, poor monetary policy, and trade barriers. Roll and Talbott found a strong relationship between economic freedom and the level of per capita income in a country, concluding that economic freedom is clearly important to a country's development:

"Liberalizations are, on average, followed by dramatic improvement in country income, while substantial reductions in growth typically follow anti-democratic events. We conclude that countries can develop faster by enforcing strong property rights, fostering an independent judiciary, attacking corruption, dismantling burdensome regulation, allowing press freedom, and protecting political rights and civil liberties. These features define a healthy environment for economic activity….

"Economic participants cannot save in a world of inflationary government-sponsored counterfeiting. They cannot compete with state-sponsored monopolies. They cannot trade efficiently with the existence of high tariffs and phony official exchange rates. They cannot easily overcome burdensome regulation and corruption. They cannot capitalize future profits in a world devoid of property rights. And they cannot prosper without economic and personal freedoms."

The study confirms that the rule of law and sound economic policies such as trade liberalization and low inflation are central to increased growth and prosperity.

MAKING AID WORK

The evidence thus indicates that economic assistance can only spur growth in countries with good economic policies and institutions – in bad policy environments, aid is far less effective and can actually be counterproductive. Taking this experience and analysis on development into account, President George Bush proposed a new development assistance program: The Millennium Challenge Account (MCA).

The MCA represents a fundamental revolution in development assistance because it would provide assistance only to countries with a proven record in adopting policies (good governance, rooting out corruption, upholding human rights, adhering to the rule of law, investing in health and education, and adopting sound economic policies that foster enterprise and entrepreneurship) that have been proven complementary and conducive to economic growth.

This focus on policies that bolster economic growth is appropriate because increased prosperity allows parents the luxury of educating their children instead of making them work to help provide for their families. Prosperity enables individuals to value green spaces for their aesthetic value rather than their potential as fields for crops or trees for fuel. It permits the workforce to worry about the quality of the work environment rather than the lack of employment. And prosperity gives families the means to engage in preventive health practices that lead to longer lives.

Similarly, a fair, strong, and reliable rule of law is necessary to give people the confidence to make long-term investments to improve their lives without fear that those investments will be arbitrarily taken from them. As noted by Peruvian economist Hernando de Soto in *The Mystery of Capital*.

"The poor inhabitants of [developing and former communist nations] – five-sixths of humanity – do have things, but they lack the process to represent their property and create capital. They have houses but not titles; crops but not deeds; businesses but not statutes of incorporation…. the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least $9.3 trillion."

It is the absence of the rule of law that keeps the poor from utilizing these assets for their own benefit.

The MCA is humble in its approach because it accepts that aid alone will not result in increased growth and prosperity and recognizes that bilateral or multilateral donors cannot force a developing country government to embrace reform against its will. A weakness of prior development efforts was trying to force reform. The difficulty of forcing governments to adopt reform is evident in the frequent failures of the International Monetary Fund (IMF) and the World Bank to impose conditionality on recipients. History shows that governments of recipient countries often pledge more than they deliver in return for IMF and World Bank assistance – a conclusion supported by World Bank analysis in *Assessing Aid: What Works, What Doesn't, and Why*, which found "conditionality is unlikely to bring about lasting reform if there is no strong domestic movement for change." The MCA recognizes that reform must be home grown if it is to endure for the long-term. Due to this reality, President Bush's insistence that the MCA should focus its resources on developing countries that have a proven track record in the policies conducive to development may be the most important aspect of the program. Instead of granting assistance to elicit reform, the program will grant assistance to countries that have already demonstrated a willingness to reform, thereby increasing the odds that those funds will be effective.

A NEW OPPORTUNITY FOR GROWTH AND PROSPERITY

The important lessons here are plain. First, increasing economic growth and individual prosperity through economic freedom must be core goals of development. Second, economic assistance can improve economic growth only in good policy environments. Third, the economic futures of developing countries lie predominantly in their own hands through the policies that they choose to adopt and enforce – long-term policy reform cannot be forced upon them.

By requiring aid recipients to prove their adherence to the policies proven to catalyze development, the MCA constitutes a welcome recognition of the limitations of development assistance while maintaining the spirit of aid by offering a helping hand to the nations striving to help themselves. ❑

1. America gave over $167 billion (in constant 1999 U.S. dollars) in official development assistance to 156 countries, regions, and territories between 1980 and 2000. Per capita gross domestic product data from 1980 to 2000 are available for only 97 of these countries. Official development assistance data are from Organization for Economic Co-operation and Development (OECD), International Development Statistics 2002 on CD-

ROM. GDP data and per capita GDP data from the World Bank, World Development Indicators 2002. A complete list of the data is available at Brett D. Schaefer, *The Millennium Challenge Account: An Opportunity to Advance Development,* Heritage Lecture #753, July 12, 2002, at http://www.heritage.org/Research/TradeandForeignAid/HL753.cfm.

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❑ THE SOCIAL ASPECTS OF THE MILLENNIUM CHALLENGE ACCOUNT: RISK AND PROSPECTS

By Stephen P. Heyneman, Professor of International Education Policy, Vanderbilt University

While the Millennium Challenge Account offers the prospect of stability and poverty reduction to many of the world's poorest nations, to succeed it will also require fundamental reform in conditions placed on countries seeking foreign aid, says Stephen Heyneman, professor of international education policy at Vanderbilt University.

Heyneman argues that if a nation "has the courage and foresight to put its macroeconomic house in order and achieve democratic public institutions, it should not be micromanaged" about how it invests in education. This type of approach would require a shift in how the international development agencies currently provide assistance for education and health, he says.

The Millennium Challenge Account (MCA) is a commitment of the United States to raise its grant aid by a factor of 50 percent over the next three years and will result in a $5 billion annual increase over current foreign aid levels. Many other countries and multinational development assistance agencies will be asked to help co-finance this new account, and their participation would augment this original proposal from the United States. The MCA offers the opportunity for a quantum change in the prospects for peace, stability, and the alleviation of poverty. But will it work?

This paper suggests that the MCA will work only if it addresses several important dilemmas in the nature of foreign aid conditionality and the terms of reference of foreign aid organizations.

THREE DECADES OF DISAPPOINTMENT

Awarded the Nobel Prize for his pioneering work on human capital, T.W. Schultz had this to say about foreign aid:

"The United States has long been a donor of various forms of aid, but the economics of aid is beset by puzzles. Why was the aid provided by the Marshall Plan successful although it was available for only a few years? Why was the large amount of aid to low-income countries since WWII much less successful? Why did the Point Four Latin American Aid Program contribute so little to the productivity in agriculture? Why have private foundations and a large number of international donor agencies had very limited success in improving the economic environment and the schooling of farm people in low-income countries?" (Schultz, 1981 p. 123)

His frustration is understandable. As a systematic endeavor, foreign aid was a creation of the post-WWII challenge. Quite naturally, the first priority was on infrastructure (bridges, dams, railroads, highways and ports) because that was the most obvious of the war's destruction both in Europe and Asia. However, the specialized development assistance agencies created during the war, such as the International Bank for Reconstruction and Development (IBRD), quickly encountered problems that were not by nature infrastructure. The challenge for the multilateral financial and development institutions was how to advance development in industry and agriculture in areas of the world free of war devastation. The problem was that these large and well-intended organizations were terribly sluggish to change their focus to meet the needs of their new clients. They continued to place priority on infrastructure in those areas of the world that had relatively low levels of human capital, weak public institutions, few democratic traditions, and high levels of inefficiency. It was this misalignment that caused so much of Schultz's frustration and impatience with foreign aid.

The struggle to place human capital on the agenda of international development assistance agencies required three decades of argumentation and went through at least two distinct stages. The first stage required the use of the economic models popular in that era, known as manpower forecasting. Widely employed in the Soviet Union and other planned economies, the technique measured "gaps" in levels of completed education by particular working groups such as manual laborers and technicians. It was thought that educational investments could be justified where "gaps" could be identified. There were two problems with using this technique. The complexities of what workers needed to actually know change rapidly, rendering earlier assumptions about manpower "requirements" irrelevant. Moreover, techniques of manpower forecasting do not include measure of costs or benefits, and as a result foreign aid programs in the 1960s and 1970s were deeply distorted. Much of the aid was limited to vocational and technical education – the most expensive part of the education sector with skills in least demand – thus wasting much of the foreign aid to education during that era.

The second stage included the use of national growth models and the estimation of costs and earnings over a working lifetime to individuals who had completed different levels of education. By using the former, one could calculate the portion of a nation's economic growth explainable by various attributes such as the size of its land, labor force, capital, and the "quality" of its workforce. In essence, it became clear in the 1960s and 1970s that a large portion of a nation's economic growth could be attributed to the quality of its labor force measured by the expansion of education and health.

Using the cost and earning approach, one could estimate the rates of return to educational investments, either from the perspective of an individual or from the perspective of a society, by comparison to investments in infrastructure or other uses of capital. Several generalizations emerged from this: the rates of return to investments in education were greater in the lower-income countries and the rates of return were greatest in basic education as opposed to higher education. These findings led to the consensus behind the initiatives for basic education and public health in the 1980s.

Much has changed since the Cold War rivalry ended, but one of the most important changes has been with the factors that affect motivation. Foreign assistance is no longer justified on the basis of competition between East and West, and the effect of this has reduced the size of the American commitment. American reductions in foreign aid have been criticized in many parts of Europe and Asia. How could a nation that precipitated the foreign aid trend after WWII become so self-absorbed?

But what many Europeans may not realize is that reductions in foreign aid have not been limited to the United States. Of the 21 donor countries in Europe, North America and Asia, by the mid 1990s, 16 of them had reduced foreign aid as a proportion of gross domestic product (GDP) (World Bank, 1996, p. 13). In industrialized nations voting publics are getting older and are concerned with issues of pensions, health insurance, and personal safety. But there have been other questions, too, about the nature of foreign aid and its effectiveness.

Many ask why we should continue to finance the needs of poor countries when many of the leaders of those countries are corrupt. Does it make sense for the struggling farmer in Sweden or Ohio to sacrifice so that a dictator can use the national treasury as his own personal bank account? In many instances nations spend their monies on armaments and waste foreign aid on superfluous conflicts in which poor people suffer. Political support for foreign aid is affected by the fact that some of the same nations that suffer from periodic starvation are also those with prominent armaments, dastardly dictators and horrible human right records.

Then there are questions about the development assistance agencies themselves. According to one U.S. congressional report, the functions of these agencies greatly overlap, over one half of the projects have failed, and often projects have been directed to the countries for reasons of political advantage rather than for principles of economics (International Financial Institutions Advisory Commission, 2000).

Why has aid failed? The research would suggest that aid has failed because it was targeted on countries that had two characteristics. They were either comparatively rich anyway and didn't need it, or their policies were hopelessly mired in distortions (Dollar and Pritchett, 1998). Where has all the aid gone? By some estimations aid has simply supplanted normal expenditures, allowing local governments to use aid for what they would have spent money on anyway, and simply shifted the increments to other budget categories with low poverty or economic impact (Shantayanan, 1998). So persistent have these challenges been that many feel that the international donor agencies themselves should be restructured and that aid might well be delivered through nongovernmental organizations, instead of official governmental agencies. Such restructuring may not be necessary. It may be possible to increase aid and to increase the economic and social impact of aid. It may be possible for taxpayers in the United States and other industrialized societies ten years from now to look back and to say, "We did a good job. We made the right choice."

WHY WE NEED AN MCA

There are three underlying reasons for the MCA. The first is the consensus that some aid has worked extraordinarily well and, more importantly, we think we know why. First in importance is that aid cannot be effective without an overall regime in which it is allowed to work. By some estimates this can be reduced to: fiscal balance, low inflation, openness to international markets, property rights, and strong public institutions with a history of low corruption. The thinking now is that a nation that cannot put effective development policies in place is unlikely to make effective use of foreign aid (Burnside and Dollar, 1998).

Apart from the large macroeconomic policy picture, there is also a consensus surrounding what aid content would not work. Aid to physical infrastructure duplicates what the private sector can supply more efficiently and often consists of palace-inspired prestige projects. Aid in-kind is not significantly different from a nation that dumps its surplus (such as grain) on other parts of the world. This inhibits local farmers and distorts incentives in the donor country. Aid cannot work if distortions originate in the donor country. For example, from a public finance point of view it is counter-productive for taxpayers in the United States to support peanut prices in Georgia and at the same time finance assistance to peanut farmers in Africa who will not be able to export because of the U.S. domestic price supports. A level playing field should be treated as a universal concept. For the MCA to be effective, each donor county will need to understand that its commitment to foreign aid will require domestic policy reforms, too.

Aid from foundations has sometimes been directed to personal and private interests. One example is the Kellogg Foundation's aid to agriculture, which has been limited by its charter to assisting agricultural extension services, an American invention that could not transfer effectively without the land grant universities and other sources of technical information (Schultz, 1981, p. 126). Aid administered from bilateral agencies (those whose programs are government-to-government) is frequently directed to countries with domestic political importance and burdened by micro-management from domestic legislation. Many seem now to agree: under these circumstances aid cannot be expected to have long-term impact.

Third, we think we know what kind of aid works best. If nested within nations with supportive economic and social principles, aid will work. But the purpose of aid is equally important. Public aid should be targeted to supporting public functions and public goods, essentially in public health and education. Aid should support the policies that can address the problems of health status in terms of infectious disease and poor behavior, in terms of dangerous sexual practices, smoking and the abuse of alcohol. In the field of education with rates of per-pupil expenditure differing from one country to another by a factor of 1:300, an investment in primary education, particularly for girls, and for simple goods and services such as textbooks, generates the highest economic returns on which data are available. There is also good evidence that an investment in education changes behavior. Farmers make more intelligent choices among a complex set of input choices; families make more intelligent choices in terms of family size, health practices, and choices of investment.

Thus the MCA offers the world an opportunity to turn the page in the field of foreign aid. It offers the opportunity to learn from our experience and to offer a realistic promise for a better world. So what are the major challenges facing the MCA?

WHAT OBSTACLES DOES THE MCA FACE?

The MCA has three underlying dilemmas. The first is that there is no commitment to stop allocating foreign aid for reasons of domestic benefit or geopolitical considerations having little to do with poverty. The problems are known, but there is little discussion of their organizational ramifications. Are donor nations likely to cease allocating foreign aid to political despots whom they need for political reasons? Is the international community ready to streamline the International Monetary Fund, the World Bank and the regional development banks so that their functions do not overlap?

The second problem is the traditional "chicken and egg" question. Of course it makes sense to allocate aid to countries that institute macroeconomic reforms. But frequently foreign aid has not been a sufficient incentive to get countries to make the necessary political and social changes. The number of countries eligible for foreign assistance under MCA rules might be reduced to a small percentage of poor countries, leaving hundreds of millions of deserving people untouched by this new program. Current aid has not been able to effectively address world poverty. Are nations that do not qualify for the MCA to be bypassed? On the other hand, if aid is advanced on the basis of need and not effectiveness, does this not encourage "moral hazard?" Do local political leaders engage in risky economic behavior on grounds that aid will arrive even after their mistakes?

The third problem is internal to the health and education sectors. International aid agencies like to think that they have discovered what went wrong in the macro environment and within the health and education sectors, too. They propose to have countries allocate public resources to public health and not to curative care, to primary education and not higher education. The problem is that these recommendations have a long history of creating their own distortions and project failures. Based on the advice of international agencies, project and policy failure have been evident since the 1960s (Bennell, 1995; Colclough, 1996). The question arises then as to who is responsible? Since all projects, even using grant aid, have local co-financing requirements, when the failure of a project is due to mistakes made by the development assistance agency, does the country get its money back? Is there a court to which a country can appeal for damages? Within development assistance agencies, who takes responsibility for failures? Are senior staff relieved of their duties when they are responsible for wasteful project designs? No.

CONCLUSION

The solution to designing a successful sectoral strategy lies in three reforms. First, international development agencies need to strengthen the access of developing countries to data on education and health. Currently the collection and quality control mechanisms are deeply flawed, and this has long-term negative consequences for developing countries. The proposed U.S. re-entry into the United Nations Educational, Scientific and Cultural Organization (UNESCO) and leadership in some arenas of education provide an excellent opportunity for the United States to help guide with a sense of professional purpose. It is true that the United States has serious education problems, but it is also true that some assets of American education are of significant value to the world. These include how the U.S. education system incorporates (through school boards and other consensus-building mechanisms) diverse ethnic interests into a consensus over what to teach the young. Clearly some of the new MCA resources need to be allocated to helping poor countries raise the level of quality of education and public health.

Second, nations need to make their own choices over what kind of education and health projects they wish to invest in, and their choices should not be determined by the source of the financing (Alexander, 2001). Basic research, doctoral level higher education new pharmaceuticals, free education, and free health care should be legitimate uses of foreign aid. If a nation has the courage and the foresight to put its macro economic house in order and achieve democratic public institutions, it should not be micro-managed about whether or not it invests in a university. This would require a shift away from having international agencies establish sector conditionality for aid in education and public health. But how likely is it that international development assistance agencies will refrain from establishing conditions for sector policies while establishing tougher conditions for macroeconomic policy?

Many of the distortions (i.e. the mistakes) made by development assistance agencies in health and education areas stem from the fact that there is an operating monopoly over development assistance. Resources for conducting the analysis (to decide sector policy) and the resources to finance development projects are situated within the same organization. There is no public defender available to poor countries. They have no equivalent analytic representation to counter what appears (at least at the outset) to be compelling social science. As a result, poor countries cannot adequately decide on their own strategies and are vulnerable to agreeing to principles to which they do not adhere and which the development assistance agency, in fact, may change.

On the other hand, there are three ways in which this monopoly over policy and program can be effectively addressed:

- By shifting resources for doing policy analyses to developing countries and allowing them to decide what to analyze and who (decided by open competitive bidding) should perform the analyses.

- By having the World Bank continue to sponsor policy analyses but have operational decisions over project monies decided by the regional development banks.

- By having education and health policy designed by the agencies within the United Nations (such as UNESCO and the World Health Organization,) instead of the agencies that provide project monies.

Third, to withdraw from the field of sector conditionality does not mean that the international community has no legitimate role in asking the question about the purpose of education. By allowing so much new money to flow into international development education, the donor community must realize that schools and school systems can be used for ill purposes as well as good. No longer should it be acceptable for a nation to sponsor a school system that exacerbates domestic social tension and threatens international political security. We must recognize that as a source of international tension, inflammatory curricula are problematic as policies that generate sudden waves of refugees, genocide, and human slavery. International agencies have taken up responsibility for monitoring trends, adjudicating claims, and recommending solutions to these other issues. Perhaps through CIVITAS and other international civics education authorities, international agencies need to take responsibility for the danger to social cohesion posed by extremist education.

It is true that human capital concerns have traditionally concentrated on the issues of skills and technologies measured by changes in marginal productivity. But it must be remembered that the first purpose of public education is that of social cohesion, and therefore the success of this new MCA initiative will lie primarily not in the improved math and science scores but in the improved understanding of the prerequisites for a stable and peaceful world. Are international organizations able to implement these untested but legitimate purposes of foreign aid? Not without making the changes suggested here. ❏

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The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. Department of State.

❑ IMPLEMENTING THE MILLENNIUM CHALLENGE ACCOUNT

U.S. GOVERNMENT
BACKGROUND PAPER
February 5, 2003

IMPLEMENTING THE MILLENNIUM CHALLENGE ACCOUNT

BACKGROUND

This Background Paper sets forth the Administration's vision for implementing the Millennium Challenge Account (MCA). As determined by the President, the MCA will be established as a new government corporation supervised by a Board of Directors composed of Cabinet level officials and led by a Chief Executive Officer nominated by the President and confirmed by the Senate.

The MCA represents a new approach to providing and delivering development assistance. The MCA's country selection process builds on recent development research that emphasizes the role a country's own policies and institutions play in its development.[1] Similarly, the implementation of MCA programs will recognize the need for country ownership, financial oversight, and accountability for results to ensure effective development assistance. These principles will be embodied in MCA contracts between the MCA Corporation and recipient countries.

A FOCUS ON GROWTH

The goal of the MCA is to reduce poverty by significantly increasing the economic growth trajectory of recipient countries. This requires an emphasis on investments that raise the productive potential of a country's citizens and firms and help integrate its economy into the global product and capital markets. Key areas of focus would include:

- Agricultural development
- Education
- Enterprise and private sector development
- Governance
- Health
- Trade and investment capacity building

GENUINE PARTNERSHIPS

The MCA will signal a new relationship between donors and recipients. Implementation will be based on a genuine partnership between the United States and the recipient country. MCA programs will be implemented by non-governmental organizations and the private sector, in addition to public sector agencies, and the MCA will strive to achieve within recipient countries a broad coalition around development investments. The recipient country's MCA program should reflect an open consultative process, integrating official interests with those of the private sector, civil society, and other donor partners, and bringing an inclusive perspective to discussions between the country and the MCA. In formulating the MCA contract, we would assume that the recipient country will take into account its Poverty Reduction Strategy Paper (PRSP) or other development plans.

The recipient country will be responsible for:

- Guaranteeing open private sector and civil society involvement in developing and implementing the MCA contract;
- Managing coordination among the MCA and other donors to maximize development impact and avoid overlapping or duplication of efforts;
- Ensuring an open and unbiased process that would identify the most promising activities to accomplish MCA goals;
- Publicizing the terms of the contract, making it clear that the responsible actors within the country would be held accountable for performance by their constituents as well as the MCA; and
- Monitoring and assessing activities needed to meet MCA contract benchmarks and goals.

The USG [U.S. government] will be responsible for:

- Providing technical assistance to help countries establish credible baseline data and to build the capacity to collect data in the future, and to strengthen public

expenditure, management and financial accountability;
- Disbursing funds in the most efficient manner to the implementers of MCA activities; and
- Monitoring MCA contract benchmarks and evaluating progress toward MCA goals.

MCA CONTRACTS

Each country would negotiate and sign a contract with the MCA Corporation that would be made public. Like a business plan, the contract would focus on a few key goals and how they would be achieved. Each MCA contract would include the following components:
- A limited number of clear measurable goals;
- A specific time frame within which the goals would be accomplished;
- The specific activities and intermediate steps that would be needed to accomplish these goals;
- Concrete, measurable benchmarks that would be used to assess progress toward the goals;
- Baseline information against which progress can be measured, or a strategy to gather baseline data where it is lacking;
- Specific benchmarks for measuring progress of, and improvement in, budgeting, tracking of expenditures and financial oversight (such as auditing, transparency, etc.);
- Mechanisms for sustaining goals accomplished under the MCA after the contract ends; and
- Conditions under which the contract would be terminated or amended.

CONTRACT ASSESSMENT AND APPROVAL

Selection as an MCA country alone will not guarantee automatic funding of all aspects of a country's proposed contract. Contract proposals would be evaluated by:
- Sectoral teams composed of USG officials and, where appropriate, outside experts and;
- A country team composed of USG officials and, where appropriate, outside experts.

The MCA will make every effort to help selected countries obtain the technical assistance necessary to ensure that their contract proposals meet the rigorous analytical standards needed both to establish the feasibility of their strategies and to ensure their effective implementation. The MCA Board will exercise final approval.

MONITORING AND EVALUATION

Monitoring and evaluation to ensure accountability for results will be an integral part of every activity for which MCA funds are used. Monitoring and evaluation will be conducted by the MCA administrative structure and/or by third-party contractors. To facilitate such monitoring, it is critical that no contract be signed unless it includes baseline data from which progress can be measured or, where it is lacking, a clear strategy for gathering such data before contract activities commence. In addition, every contract would specify regular benchmarks for evaluating progress, and suggested corrective actions to be implemented to keep the program on track. All evaluations, as well as the terms of the contract, would be made public in the United States and the host country.

Several kinds of activities will be monitored:
- Financial responsibility/accountability;
- Auditing to ensure that data reported by recipients is accurate and complete;
- Overall budget data to demonstrate clearly that recipient governments are using MCA resources along with their own domestic and other development resources in a complementary manner aimed at development results and priorities;
- Specific benchmarks for measuring progress toward program goals; and
- Sustained country commitment to MCA selection criteria.

Monitoring should be conducted by:
- Independent contractors with professional auditing expertise and/or the MCA Corporation for financial accountability, data accuracy, country budget allocations, and specific benchmarks; and the
- MCA Board for conformity with selection criteria.

TERM AND SUSTAINABILITY

MCA contracts will fund activities for a limited term and will provide for a mid-term review. There can be "incentive clauses" in the contract to stimulate better performance.

All activities initiated under the MCA will have to be sustainable once the contract term ends. Recipients will have to be clear about how the funding for recurrent costs, if needed, would be provided.

TERMINATION

Programs will continue to receive funding, subject to congressional appropriation, under the terms of the country's MCA contract unless they fail to meet the specific conditions for performance specified in the contract. Funding for all or part of the MCA contract could be scaled back or ended for:

- Failing to meet financial standards/accountability; or
- Failing to attain specific benchmarks.

Country participation in the MCA could be terminated for:

- Failing to meet qualifying criteria as indicated by an absolute decline in the policy environment related to ruling justly, investing in people, or promoting economic freedom; or
- Material changes in conditions affecting development prospects (e.g. military coups). ❑

1. See November 25, 2002, White House Fact Sheet, The Millennium Challenge Account

❑ THE MILLENNIUM CHALLENGE ACCOUNT

THE WHITE HOUSE
FACT SHEET
November 25, 2002

THE MILLENNIUM CHALLENGE ACCOUNT

"We must tie greater aid to political and legal and economic reforms. And by insisting on reform, we do the work of compassion. The United States will lead by example. I have proposed a 50-percent increase in our core development assistance over the next three budget years. Eventually, this will mean a $5 billion annual increase over current levels.

These new funds will go into a new Millennium Challenge Account, devoted to projects in nations that govern justly, invest in their people, and encourage economic freedom."
— President George W. Bush, Monterrey, Mexico, March 22, 2002

BACKGROUND

At the Inter-American Development Bank on March 14, 2002, President Bush called for "a new compact for global development, defined by new accountability for both rich and poor nations alike. Greater contributions from developed nations must be linked to greater responsibility from developing nations." The President pledged that the United States would lead by example and increase its core development assistance by 50 percent over the next three years, resulting in an annual increase of $5 billion by FY [fiscal year] 2006. These funds will go into a new Millennium Challenge Account (MCA). Because sound policies are an essential condition of development, the President announced that the Millennium Challenge Account will be "devoted to projects in nations that govern justly, invest in their people and encourage economic freedom."

ADMINISTRATION

The MCA will be administered by a new government corporation designed to support innovative strategies and to ensure accountability for measurable results.

- The Corporation will be supervised by a Board of Directors composed of Cabinet level officials. The Secretary of State will be the Chairman of the Board.

- The CEO [chief executive officer] of the Millennium Challenge Corporation will be nominated by the President and confirmed by the Senate.

- Personnel will be drawn from a variety of government and non-government agencies and would serve limited-term appointments.

- The Corporation will be designed to make maximum use of flexible authorities to optimize efficiency in contracting, program implementation, and personnel.

COUNTRY ELIGIBILITY

Funding for the MCA will increase over three years to $5 billion per year in FY 2006. The number of countries eligible to compete for funding will also increase over this period. Specifically:

- In FY'04, the first year of MCA operation, countries eligible to borrow from the International Development Association (IDA), and which have per capita incomes below $1,435, (the historical IDA cutoff) will be considered.

- In FY'05, all countries with incomes below $1,435 will be considered.

- In FY'06, all countries with incomes up to $2,975 (the current World Bank cutoff for lower middle income countries) will be eligible.

- Country eligibility will be reviewed by the Board.

- Countries prohibited from receiving assistance by current statutory restrictions will not be eligible.

PERFORMANCE INDICATORS

In his March 14 speech President Bush directed that countries be identified based on "a set of clear and concrete and objective criteria" that would be applied "rigorously and fairly." The President stated that the Millennium Challenge Account will "reward nations that root out corruption, respect human rights, and adhere to the rule of law… invest in better health care, better schools and broader immunization… [and] have more open markets and sustainable budget policies, nations where people can start and operate a small business without running the gauntlets of bureaucracy and bribery."

The following 16 indicators (with sources), chosen because of the relative quality and objectivity of their data, country coverage, public availability, and correlation with growth and poverty reduction, will be used to assess national performance relative to governing justly, investing in people, and encouraging economic freedom.

Governing Justly:
- Civil Liberties (Freedom House)
- Political Rights (Freedom House)
- Voice and Accountability (World Bank Institute)
- Government Effectiveness (World Bank Institute)
- Rule of Law (World Bank Institute)
- Control of Corruption (World Bank Institute)

Investing in People:
- Public Primary Education Spending as Percent of GDP (World Bank/national sources)
- Primary Education Completion Rate (World Bank/national sources)
- Public Expenditures on Health as Percent of GDP (World Bank/national sources)
- Immunization Rates: DPT and Measles (World Bank/UN/national sources)

Promoting Economic Freedom:
- Country Credit Rating (Institutional Investor Magazine)
- Inflation (IMF)
- 3-Year Budget Deficit (IMF/national sources)
- Trade Policy (Heritage Foundation)
- Regulatory Quality (World Bank Institute)
- Days to Start a Business (World Bank)

PERFORMANCE ASSESSMENT

The indicators will be used to identify better performing countries. Because a straight ranking determined by adding together the scores for all sixteen indicators might allow exceptional performance in some areas to outweigh dismal performance in others, countries will qualify as better performers only if they demonstrate commitment in all three policy areas. Accordingly:

- To qualify as a better performer a country would have to score above the median on half of the indicators in each of the three policy areas.

- Because scores correlate with income, separate competitions will be run for countries with incomes below $1,435 and those with incomes between $1,435 and $2,975.

- This methodology:
  -- Assures that countries are committed in all three policy areas;
  -- Allows countries to precisely identify areas needing improvement; and
  -- Limits bias against low–income countries.

- The MCA is intended to make substantial new financial resources available to countries. Given this commitment, and the link between financial accountability and success, countries failing to perform above the median on the corruption indicator will be ineligible, absent material change in their circumstances.

FINAL SELECTION

Qualifying as a better performer will not guarantee MCA support. There may be gaps or lags in the data, or trends not reflected in the data, which may be material for assessing performance. The MCA Board of Directors will make a final recommendation to the President. In so doing, the Board will be:

- Guided by country performance on the indicators;

- Empowered to take account of data gaps, lags, trends, or other material information, including leadership, related to economic growth and poverty reduction; and

- Encouraged to identify for special transition support a small number of countries that barely miss the list of better performers. Regular development assistance can be made available to improve their chances in future competitions. ❑

❑ MILLENNIUM CHALLENGE ACCOUNT UPDATE

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
FACT SHEET
June 3, 2002

MILLENNIUM CHALLENGE ACCOUNT UPDATE

On March 14, 2002, President Bush announced that the United States will increase its core assistance to developing countries by 50 percent over the next 3 years, resulting in a $5 billion annual increase over current levels by FY 2006. This increased assistance will go to a new Millennium Challenge Account (MCA) that funds initiatives to improve the economies and standards of living in qualified developing countries. The goal of the MCA is to reward sound policy decisions that support economic growth and reduce poverty.

The President instructed the Secretary of State and the Secretary of the Treasury to develop a set of clear, concrete, and objective criteria for measuring progress. To aid in this process, the Administration is reaching out to other potential donor countries, developing countries, non-governmental organizations (NGOs), universities and think tanks, the private sector, and other interested parties.

AID LINKED TO SOUND POLICIES

The MCA recognizes that economic development assistance can be successful only if it is linked to sound policies in developing countries. In sound policy environments, every dollar of aid attracts two dollars of private capital. In countries where poor public policy dominates, aid can harm the very citizens it is meant to help – crowding out private investment and perpetuating failed policies.

The funds in the Millennium Challenge Account will be distributed to developing countries that demonstrate a strong commitment toward:

- **Good governance.** Rooting out corruption, upholding human rights, and adherence to the rule of law are essential conditions for successful development.

- **The health and education of their people.** Investment in education, health care, and immunization provide for healthy and educated citizens who become agents of development.

- **Sound economic policies that foster enterprise and entrepreneurship.** More open markets, sustainable budget policies, and strong support for individual entrepreneurship unleash the enterprise and creativity for lasting growth and prosperity.

MILLENNIUM CHALLENGE ACCOUNT GUIDING PRINCIPLES

In order to ensure that Millennium Challenge Account funds promote growth and reduce poverty in developing nations, funds will be distributed according to the following guiding principles:

- Country selection will be keyed to potential for economic growth and poverty reduction. All countries selected will have demonstrated their commitment to sound policies in the areas listed above.

- Funds will be distributed in the form of grants. Where appropriate, programs funded by this account will be coordinated with ongoing programs and leverage other funding streams, both from within the recipient country and from other private, bilateral and multilateral donors.

- Qualifying countries will be encouraged to actively engage with us in formulating uses for MCA funding through a participatory process involving local and federal elected officials, civil society, and development partners.

- The development priorities, investment needs, and growth potential of selected countries will determine how funds are allotted.

- Where possible, the Millennium Challenge Account will seek to broaden development partnerships by including new partners, such as private sector firms, national and local governments, U.S. and local universities, foundations, and international and local NGOs [non-governmental organizations].

• Building capacity for quality data development and continuous country and project performance monitoring will be important components of the MCA and will be incorporated into its implementation.

THE ADMINISTRATION'S COMMITMENT TO THE DEVELOPING WORLD

The United States is the world's largest bilateral donor to the developing world. While many donors provide economic assistance, the United States provides resources both to strengthen security and foster economic growth. Congress appropriated $17.1 billion to support these activities in FY [fiscal year] 2002.

KEY FACTS

• The United States is the world leader in humanitarian assistance and food aid, providing over $2.5 billion in 2001.

• The United States is the top importer of goods from developing countries, importing $449 billion in 2001, eight times the amount of total Official Development Assistance (ODA) to developing countries from all donors.

• The United States is the greatest source of private capital to developing countries, averaging $36 billion annually between 1997 and 2000.

• The United States leads the world in charitable donations to developing countries – $4 billion in 2000.

• At $11 billion, the U.S. is the top provider of Official Development Assistance (ODA) in 2001. This ODA is expected to increase substantially from 2001 to 2003 in key sectors:

-- HIV/AIDS – 54 percent
-- Basic Education – 50 percent
-- Trade and Investment – 38 percent
-- Agriculture – 38 percent

• USAID's core "Development Assistance" account is expected to increase 22 percent overall from 2001 to 2003, with significant increases in key regions:

-- Africa – 30 percent
-- Asia and the Near East – 39 percent
-- Latin America and the Caribbean – 29 percent

• The United States is the largest donor to the multilateral development banks (MDBs). The Administration's FY 2003 budget request for the MDBs totals more than $1.4 billion and includes significant increases in U.S. contributions to both the International Development Association and the African Development Fund.

• The MCA will complement, not replace, these existing efforts. ❑

KEY CONTACTS AND INTERNET SITES

UNITED STATES GOVERNMENT

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
http://www.mca.gov

THE WHITE HOUSE
http://www.whitehouse.gov/infocus/developingnations/

LINKS TO MCA INDICATORS

FREEDOM HOUSE
Indicators: Civil Liberties, Political Rights
http://www.freedomhouse.org/ratings/index.htm

WORLD BANK INSTITUTE
Indicators: Voice and Accountability, Government Effectiveness, Rule of Law, Control of Corruption, Regulatory Quality
http://www.worldbank.org/wbi/governance/mca.htm
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Subscriber service:
http://www.institutionalinvestor.com/platinum/

INTERNATIONAL MONETARY FUND
Indicators: Inflation, 3-year budget deficit
International Financial Statistics subscriber service:
http://ifs.apdi.net/imf/about.asp

WORLD BANK
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