
□ 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 country 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. □

Alexander, Nancy C. "Paying for Education: How the World Bank and the International Monetary Fund Influence Education in Developing Countries." *Peabody Journal of Education*, Nos. 3 and 4, 2001, pp. 285 - 339.

Bennell, Paul. "Using and Abusing Rates of Return: A Critique of the World Bank's 1995 Education Sector Review." *International Journal of Education Development*, No. 16, 1996, pp. 235 - 48.

Burnside, Craig and David Dollar. *Aid, The Incentive Regime and Poverty Reduction*. Washington D.C.: World Bank, 1998.

Colclough, Christopher. "Education and the Market: Which Parts of the Neo-liberal Solution Are Correct." *World Development*, No. 24, 1996, pp. 589 - 610.

Dollar, David and Lant Pritchett. *Assessing Aid: What Works and What Doesn't and Why*. Washington D.C.: World Bank, 1998.

International Financial Institutions Advisory Commission. *The Meltzer Commission Report*. Washington D.C.: US Government Printing Office, 2000.

Schultz, T.W. *Investing In People: The Economics of Population Quality*. Berkeley, CA: University of California Press, 1981.

Shantayanan, Swaroop. *The Implications of Foreign Aid Fungibility for Development Assistance*. Washington D.C.: World Bank, 1998.

World Bank. *Global Economic Prospects and the Developing Countries*. Washington D.C.: World Bank, 1996.

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