

THE MILLENNIUM CHALLENGE ACCOUNT

HEARING
BEFORE THE
COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES
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THE MILLENNIUM CHALLENGE ACCOUNT

THURSDAY, MARCH 6, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Committee met, pursuant to call, at 10:07 a.m. in Room 2172, Rayburn House Office Building, Hon. Henry J. Hyde (Chairman of the Committee) presiding.

Chairman HYDE. The Committee will come to order. Thank you for joining us today. The purpose of today's hearing is to learn about the President's proposal for a new type of foreign assistance. It is based on the revolutionary idea that countries must be accountable for their actions, be responsible for developing and advancing their own plans of progress, and must show results in order to receive continued assistance from the American taxpayer.

The Millennium Challenge Account was developed and advanced by a President who is willing to take a risk with a bold, new idea. Actually demanding accountability from our foreign-aid programs is really not such a new idea. In the past and, most recently, the 107th Congress, I introduced a bill called the Foreign Aid Effectiveness Act, which required the President to describe the actual results of U.S. foreign assistance relative to the goals and identify the most and least successful foreign-assistance programs.

Today, we will hear from three senior officials from the Administration. Administrator Natsios returns to the Committee to testify on the new compact for development, the initiative announced almost a year ago by the President in his March 14, 2002 speech at the Inter-American Development Bank. We will also hear from Under Secretaries Larson and Taylor of the Departments of State and Treasury, respectively, on eligibility criteria and the proposed structure and organization of the Millennium Challenge Corporation, the new organization proposed to manage MCA assistance.

Many U.S. aid programs have not achieved results over the years. Some assistance has allowed corrupt leaders to amass personal fortunes and remain in power beyond the will of the citizenry. Other aid has allowed leaders and governments to abdicate responsibility for effective governance and pursue detrimental, self-destructive or personally self-enriching policies. Other assistance has gone to consultants of middlemen, with little results to show in the end. These failures of the past should not lead us to turn our backs on the developing world—just the opposite. Now is the time for American leadership and for America to recognize, through its aid, those countries that respect the rights of citizens, promote democracy, and encourage economic freedom and prosperity. How-

ever, we need to demonstrate what works and what does not. We need to hold accountable those governments and leaders who do not choose the right path of reform.

The President's proposal for a Millennium Challenge Account deserves the support of the Congress. We should embrace the idea of increasing U.S. economic assistance but only to those countries that demonstrate a commitment to human rights, democratic ideals and practices, and investment in people.

I look forward to hearing from our witnesses today on this important initiative, and now, with pleasure, I recognize the Ranking Member of the Committee, my good friend, Mr. Lantos.

Mr. LANTOS. Mr. Chairman, thank you very much for calling this hearing and again exhibiting strong bipartisan, statesman-like leadership in focusing our attention on this important issue.

The Millennium Challenge Account, as conceived by the President and considered by this Committee, represents one of the most ambitious and far-sighted foreign-assistance initiatives in our nation's history. The Millennium Challenge Account has the potential of revolutionizing the way in which the United States promotes democracy and development abroad.

High-performing, poor countries stand to gain at least \$1.3 billion in the next fiscal year and \$5 billion by 2006, nearly double the amount of development assistance that we provided last year.

The MCA represents not just a quantitative leap forward but a qualitative contribution as well. By linking U.S. assistance to progress toward poverty reduction, democracy, free markets, the rule of law, human rights, and other key indicators, the MCA offers a powerful incentive to emerging societies to develop consistent with our values.

For some time now, humanitarian assistance has remained politics free. We have maintained that food and other life-saving assistance should not be used either as a weapon or as a means of political enticement.

Finally, development assistance is on the verge of being freed of strategic considerations so as to promote development as a long-term U.S. interest.

The MCA, Mr. Chairman, also promises to destroy one of the enduring legislative taboos that has handicapped our U.S. foreign policy for too long. Foreign assistance is a dirty word on Capitol Hill. Lawmakers routinely malign it as a wasteful form of international welfare. Such irresponsible and ill-informed talk misleads many of our fellow citizens. Polls show that they believe that some 15 percent of the Federal budget is spent on foreign aid, when, in fact, less than 1 percent of the budget is allocated for that purpose, representing the lowest percentage among western industrialized nations.

The Secretary of State said that foreign assistance has no domestic constituency; and, therefore, it is vulnerable to congressional cuts. By issuing this challenge, the President has made clear that foreign assistance is, in fact, an item which has a truly national constituency. All Americans benefit from foreign assistance that gives hope to the impoverished and opportunity to the willing.

The Millennium Challenge Account, as its name implies, represents a very significant challenge to the Congress, and I applaud

you, Mr. Chairman, for meeting this challenge and demonstrating bipartisan leadership toward achieving the President's goal. By launching debate on the Millennium Challenge Account in the House with this hearing and by stating your intention to mark up the legislation later this month, you are asserting the Committee's rightful role. Simply put, the issues involved are too important and the sums involved too great to leave the MCA solely to the discretion of our colleagues on the Appropriations Committee.

I strongly support your efforts, Mr. Chairman, to tackle the Millennium Challenge Account in this Committee, where it belongs. However, as we do so, Mr. Chairman, allow me to express three concerns about the Administration's proposed legislation. Firstly, I am deeply disappointed that the Administration's budget request does not fulfill the President's pledge to provide \$1.7 billion for the MCA in fiscal year 2004. It short-changes the account by \$370 million, or over 20 percent, right from the start. I think we have to be very careful about these things. Leave No Child Behind legislation, which received such strong bipartisan support, has also fallen short with respect to funding requests.

The MCA is an investment in the future in which every dollar counts. Should we underfund this investment now, the dividends we reap in the future will be exponentially less.

Secondly, Mr. Chairman, I have severe reservations about the Administration's proposal to create a new, independent agency to administer the MCA and to further fragment U.S. foreign assistance. Responsibility for administering this account, in my judgment, should rest with the U.S. Agency for International Development (USAID). USAID has nearly 40 years of experience in administering U.S. foreign-assistance programs, and no new agency could match this record. Its expert field staff's strong relationships with NGOs and aid recipients, and global perspective on assistance make USAID especially well equipped to undertake the Herculean endeavor that implementing the MCA will entail. An empowered USAID, not more bureaucracy, red tape, and foreign-aid balkanization, is what we need to make MCA a success.

Finally, Mr. Chairman, I am concerned about the strict criteria laid out in the selection of countries that will be eligible for foreign aid. We have some 16 criteria, coming from a variety of sources. As one who has spent a great deal of time in an earlier incarnation on admitting students to prestigious academic programs, I know only too well how imprecise these criteria are, and their mechanical implementation can lead to horrendous inequities. I also believe that the notion that each criterion is of equal value is predicated on a fundamentally mistaken assumption.

Clearly, democracy ought to be a prime criterion, yet India is excluded from receiving aid in the first instance. Now, to exclude the world's largest democracy, a friend and ally supportive of the United States in so many arenas, does not make any sense to me. So while I applaud the attempt to move toward some degree of objectivity, I think we will have to return some discretion with respect to the selection of countries that will be eligible for aid.

These concerns, Mr. Chairman, do not diminish my support for the goals of this bold initiative. Fully funded and properly managed, MCA promises to provide critical assistance to our partners

in democracy and development while strengthening our diplomatic hand around the globe. At a time when some of our allies are questioning their support for U.S. foreign policy and goodwill toward the United States is eroding in many parts of the world, MCA will remind the world of the principles for which we stand and for which we support others. Thank you, Mr. Chairman.

Chairman HYDE. Thank you, Mr. Lantos. Any other opening statements that other Members might have, without objection, will be made a part of the record. Our witnesses all have other engagements, and we want to get not only to their statements, but we want to question them. Mr. Lantos has indicated several problems, and I think they deserve being addressed.

To open our first panel today, we welcome back Alan P. Larson, who is Under Secretary of State for Economic, Business and Agricultural Affairs at the Department of State. Ambassador Larson assumed his duties in November 1999 and continues to serve as the senior economic official advising the Secretary of State on international economic policy and leading the work of the department on issues ranging from trade and aviation to bilateral relations with America's economic partners.

Ambassador Larson has been a career public servant, serving at a high level in the Department on a number of endeavors involving economic and business affairs and international energy policy and resources. He has represented the United States overseas in Jamaica, Zaire, and Sierre Leone.

Ambassador Larson has a Ph.D. in economics from the University of Iowa, and has attended Johns Hopkins School of Advanced International Studies. He is married and has three children.

Joining our panel as our second witness is John Taylor, who assumed the responsibilities of Under Secretary for International Affairs at the Department of Treasury in June 2001. As Under Secretary, he serves as principal adviser to the Secretary of the Treasury on international, economic, and financial issues and leads the development and the implementation of policies in the areas of international finance, trade, and investment, economic development, international debt, and U.S. participation in the International Monetary Fund, the World Bank, the Inter-American Development Bank, and many other world financial institutions. He also helps coordinate U.S. Treasury policy with the finance ministries of the G-7 industrial nations.

Under Secretary Taylor's previous governmental experience includes economic responsibilities from 1976 to the present, both at the Federal and state levels. He has been the Roberts Professor of Economics at Stanford and is globally recognized as an expert and researcher on international monetary and financial issues.

Under Secretary Taylor earned a B.A., *summa cum laude*, from Princeton and his Ph.D. from Stanford. He is married and has two children.

Joining our panel as our third witness is Andrew S. Natsios, Administrator of the United States Agency for International Development, the government agency that administers economic and humanitarian assistance worldwide. Ambassador Natsios has served USAID for many years prior to becoming the Administrator, first, as Director of the Office of Foreign Disaster Assistance, then as As-

sistant Administrator for the Bureau for Food and Humanitarian Assistance. Before coming to the Federal Government, he served in the State Legislature of his native Massachusetts, where his tireless work earned him Legislator of the Year honors from numerous organizations.

Ambassador Natsios is a graduate of Georgetown University and Harvard University's Kennedy School of Government. He has taught graduate and undergraduate courses at Boston College, the University of Massachusetts, and Northeastern University. He is an Army veteran of the Gulf War, and he and his wife, Elizabeth, have three children. Of course, we look forward to hearing your statement today, Mr. Administrator.

We welcome all of our panelists today and ask that they begin with a summary of their statements. Your full statements will be made a part of the record. I might add that the record will remain open for a period of 5 days from the date of this hearing for the inclusion of any additional statements, and may we begin with you, Mr. Larson.

STATEMENT OF THE HONORABLE ALAN P. LARSON, UNDER SECRETARY, OFFICE OF THE UNDER SECRETARY FOR ECONOMIC, BUSINESS AND AGRICULTURAL AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. LARSON. Mr. Chairman, Mr. Lantos, and distinguished Members of this Committee, it is a great honor to testify on behalf of the Millennium Challenge Account. Last March, President Bush caught the attention of the world when he called for a new compact for global development, linking greater contributions from developed countries to greater responsibility from developing countries. It was not just the amount of money that attracted the interest; it was also that the Millennium Challenge Account brought together the lessons about development that had been learned over the last 50 years.

The Millennium Challenge Account targets countries that govern justly, invest in their own people, and encourage economic freedom, and by focusing on those countries whose own economic policies encourage growth, MCA assistance will deliver much greater economic development, and for those countries that do not qualify initially, the MCA already is providing a very strong incentive to adopt growth-enabling policies. The MCA is a true partnership in which developing countries, with the full involvement of their own citizens, will set forth their priorities and propose their own projects.

The MCA insists on results. We propose to have business-like contracts with each partner and to invest our resources in well-implemented programs that have clear objectives and built-in performance benchmarks.

To realize the President's vision, the Administration's development team, including the three of us at this table and many others, engaged in an intensive, year-long process of policy formulation. We received thoughtful suggestions from many, including non-governmental organizations and the business community, and throughout the process President Bush and his cabinet gave un-

precedented direct and sustained attention to the Millennium Challenge Account and to other development issues as well.

After a year of deliberation, we come to you with conclusions reflected in the legislation before you. First, the MCA should focus on promoting economic growth and development outcomes in countries with good policies.

Second, the MCA must complement, not replace, other assistance. In fact, the President seeks to expand other assistance programs, including those that provide famine relief, that combat HIV/AIDS, and that help strategic partners. The MCA will not come at the expense of USAID.

Third, the MCA must have a strict and transparent selection process. We have chosen 16 publicly available indicators to help inform decisions about which countries will participate. Secretary Powell and the Administration are committed to keeping the MCA clearly focused on developmental objectives.

Fourth, the MCA should be administered by a separate corporation. Combining all of the new elements here—a selective qualification process, a partnership that gives developing countries the lead, a business approach that measures results from the beginning to the end—all of this requires a new approach, and the legislation proposes a lean, Millennium Challenge Corporation headed by a chief executive officer nominated by the President and confirmed by the Senate. The CEO would report to a board of directors chaired by the Secretary of State.

Fifth, the MCA needs a clean, flexible, legislative mandate. If it is to respond to developing-country priorities, the MCA cannot be earmarked. If it is to attract the best and the brightest personnel from the public sector, from the private sector, and from the non-profit sector, the MCA must have special personnel authority, and if it is to be lean and efficient, it must have the ability to contract broadly for services.

And, sixth, the MCA must be accountable and coherent with other development programs. As Chairman of the board of directors, Secretary Powell is determined to ensure that the MCA is accountable to the President and accountable to the Congress and is well coordinated with the activities of USAID, which he also oversees.

Mr. Chairman, I would like to close very briefly on a personal note. My involvement with developing countries began 32 years ago as a teacher in a self-help school in Kenya, and since then, as you mentioned, I have served as a diplomat in Sierre Leone, in Zaire, in Jamaica. I ran small assistance programs, and I promoted development policies like the Caribbean Basin Initiative. I have had the privilege of traveling on behalf of our country all over the world to observe different types of development strategies and approaches.

I am convinced that the proposal before the Committee today is the most thoughtful and most important American development initiative to be advanced in the last 32 years. It is built on American values, embracing both our compassion and also our insistence on practical results. It also comes at a time when our nation is engaged in a war against global terrorism, yet even as we fight to defeat terrorism, it is vitally important, in the words of President

Bush, to fight for the values that make life worth living: Education, health, and economic opportunity.

I urge the Committee to give the Millennium Challenge Act of 2003 its full support. Thank you, sir.

[The prepared statement of Mr. Larson follows:]

PREPARED STATEMENT OF THE HONORABLE ALAN P. LARSON, UNDER SECRETARY, OFFICE OF THE UNDER SECRETARY FOR ECONOMIC, BUSINESS AND AGRICULTURAL AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. Chairman, members of the committee, I am pleased to appear before you to testify in favor of the establishment of the Millennium Challenge Account (MCA).

Last March, President Bush described an exciting new approach to development assistance. He called for “a new compact for global development” linking “greater contributions from developed nations” to “greater responsibility from developing nations.” The United States would lead by example, the President pledged, and increase core development assistance by 50 percent over the next three years—an increase of \$5 billion per year by the third year. A Millennium Challenge Account would channel this new assistance only to “nations that govern justly, invest in their people, and encourage economic freedom.”

WHY A MILLENNIUM CHALLENGE ACCOUNT?

Mr. Chairman, this new foreign assistance initiative, the Millennium Challenge Account, brings together in a new and innovative way the lessons we have learned about development over the past 50 years.

- It affirms that economic growth is key to development and targets assistance at those countries that have adopted the governance, health, education and economic policies that enable growth. In this way, the MCA increases the odds of spurring successful economic development and, at the same time, encourages more countries to adopt growth-enabling policies.
- It recognizes that development must primarily come from within, not conferred from the outside. No one can develop a country except its own people. The MCA thus proposes a true partnership in which the developing country with full participation of its citizens proposes its own development priorities and plans.
- It insists on results. Funds will go to those countries that have the best proposals—with clear objectives and benchmarks—and those that best implement their programs.

The MCA builds on the promise of the global economy and the spread of democratic institutions. It rests on the greater recognition by developing countries that their policies and governance are the most critical keys to development. The MCA is not the sole answer. It is part of a broad array of Administration efforts to spur development that stretch from the Doha Development Agenda to initiatives on HIV/AIDS, famine and education. Along with these other efforts, the MCA supports our overall foreign policy, including the struggle against terrorism, by encouraging free, democratic and prosperous societies where people have a stake in the future and value partnership with the United States.

The Administration’s vision of the MCA, as reflected in the legislation sent forward to the Congress on February 3, is profoundly positive. It affirms the ability of the poorest people in the poorest countries to improve their lives; it embraces human dignity by stressing mutually responsible and accountable partnership; and it upholds the key insight that thoughtful and participatory political and economic governance are fundamental to lasting progress.

DEVELOPING THE MCA

This past year our challenge has been to implement the vision that the President put forward last March in Monterrey. In so doing, we have engaged in an intense, thoughtful and collegial interagency process involving the Departments of State and Treasury, the U.S. Agency for International Development, the Office of Management and Budget, the National Security Council, and a number of other agencies. We have also benefited greatly from the strong interest and suggestions of many, including from members of congress and staff. The public, especially the NGO and business communities, have been vital advisors and sounding boards. We have kept other donor nations and potential MCA beneficiary countries apprised, as both have welcomed the MCA and been keen observers of our progress. Throughout this proc-

ess, the involvement of the President has been central. President Bush has given an unprecedented level of direct and sustained commitment to the MCA and to development issues more generally.

After months of discussion and deliberation, the Administration came to a number of conclusions:

- The MCA should focus on development objectives;
- It must complement, not replace current assistance;
- To ensure we select only those countries that can best use assistance, the MCA requires the integrity of objective eligibility criteria;
- To combine all the new elements—a selective program, partnership that gives developing nations themselves the lead role in guiding their development, and a program where results are integrated and measured from beginning to end—we decided that the MCA could not just be grafted onto existing assistance programs or structures;
- We also concluded that to realize the promise of the MCA without a huge increase in bureaucracy, we will have to organize and run the MCA in a whole new way, requiring a clean, flexible and creative legislative mandate.

LEGISLATIVE OVERVIEW

Mr. Chairman, to make this vision a reality, the legislation before you would create a new organization—the Millennium Challenge Corporation (MCC)—with one key goal: “to reduce poverty through promoting sustained economic growth in developing countries committed to implementing good policies.” A Chief Executive Officer nominated by the President and confirmed by the Senate would run the MCC. A cabinet-level board, chaired by the Secretary of State, would provide policy guidance and oversee operations. This will ensure policy consistency and coordination between the MCA and other foreign assistance, which by law the Secretary of State supervises.

Selection: Only poor countries will be eligible for the MCA. In FY 2004, 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. As funding expands, we would also gradually expand the countries eligible for participation in the MCA. In 2005, all countries with incomes below \$1,435 will be considered. In 2006, all countries with incomes up to \$2,975 (the current World Bank cutoff for lower middle income countries) will be eligible.

At the heart of the MCA is a challenge to countries to create and maintain the policy and institutional environment that underpins lasting development and makes assistance truly effective. We have therefore based MCA qualification on these criteria and have chosen 16 indicators, falling into three baskets: ruling justly, investing in people and encouraging economic freedom. In order to participate in the MCA, countries would be expected to do better than the median on half the indicators in each category. We will give special attention to the corruption indicator, since corruption has such a corrosive effect on democratic institutions and developmental achievement.

The sources for these indicators, and the data for evaluating them, will be publicly available. By giving countries access to the information they need to qualify, the MCA helps to give poor countries incentive and direction to develop the policies required. The indicators come from independent and analytically rigorous sources, including the multilateral development banks, academic policy institutes, international financial institutions and non-profit organizations. When countries create the policies to meet these indicators, they will create the conditions friendly to sustained economic growth.

We know that indicators cannot capture all critical aspects of a country’s performance in these areas and may not be fully up to date. The legislation addresses this by providing for discretion by the Board of Directors to exercise final judgment as to which countries will qualify. Secretary Powell and this administration are absolutely committed to keeping the MCA focused on development, with the basis for qualifying reflected in the President’s three categories. We have other tools, including development assistance and economic support funds, to address other important national goals.

Implementation: To implement the partnership between the MCA and MCA countries, the MCA will use time-limited, business-like contracts that represent a commitment between the United States and the developing country to meet agreed performance benchmarks. Developing countries will set their own priorities and identify their own greatest hurdles to development. They will do so by engaging their citizens, businesses and government in an open debate, which will result in a proposal

for MCA funding. This proposal will include objectives, a plan and timetable for achieving them, benchmarks for assessing progress and how results will be sustained at the end of the contract, delineation of the responsibilities of the MCA and the MCA country, the role of civil society, business and other donors, and a plan for ensuring financial accountability for funds used. The MCA will review the proposal, consulting with the MCA country. The Board will approve all contracts.

To be most effective in promoting development, the MCA will need flexible authorities with regard to funding, personnel, procurement and contracting. The MCA will fund programs to promote economic growth. We envision a focus on areas such as agricultural development, education, enterprise and private sector development, governance, health, and trade and investment capacity building, but to be able to respond to MCA country proposals, the MCA should not be restricted to specific areas of funding.

The Millennium Challenge Corporation will draw its staff from the best and brightest in the public, private and non-profit sectors. We envision a relatively small staff, which would serve for time-limited terms. The staff would rely heavily on contracted services for monitoring, evaluation and many services. The MCA will need the ability to contract for services with the private sector, with government agencies, and with international organizations and should be able to procure globally.

Funding: The initial funding request for the MCA is \$1.3 billion. This is the first stage of a ramp-up that will increase to \$5 billion by 2006. That is a 50 percent increase in current core US development assistance, and represents an unprecedented effort to reduce poverty. We believe \$1.3 billion will provide sufficient resources for a strong start. We deliberately chose to ramp up requests over time to ensure funds would match but not exceed our ability to use them well.

Operation: Mr. Chairman, we know that the keys to success of any initiative as innovative as the Millennium Challenge Account lie not only in ensuring that it has a well thought out mandate and the needed authorities. It must also operate well. We have sought to give the MCA a unique identity so that it will work well with other agencies that deliver development assistance. We have kept its staff small, so that it will rely on other agencies in the field and in Washington. We have placed MCA officials in the field under Chief of Mission authority to ensure that they coordinate well with other Embassy elements, including the AID mission. And to ensure accountability, the Secretary of State, who oversees all of our foreign assistance programs, will serve as Chairman of the Board.

USAID will continue to be central to U.S. foreign assistance. The Administration is working hard to bring forward new development initiatives on agricultural development, famine, HIV/AIDS, rural poverty, trade capacity building and humanitarian relief. Under the committed leadership of Administrator Natsios, USAID will not only have a growing role in these new development assistance initiatives, but it will also be a key partner of the MCA and the implementing agency for many MCA programs. In fact, USAID programs will work in partnership with the MCA to provide technical assistance and other funding for those countries that are "near qualifiers," so that they can make the policy changes necessary to qualify for the MCA.

WHAT THE MCA CAN ACHIEVE

Mr. Chairman, in conclusion, the Millennium Challenge Account is an innovative effort to spark international development that deserves support. While many of the elements of the MCA are not new, this will be the first attempt to integrate them into a concept that challenges countries to adopt policies that enable development, that challenges aid recipients to take the lead in a new form of partnership, and that challenges us and MCA countries alike to adopt a business-like, results-oriented approach. The MCA's goal and mission are clear: to raise countries out of poverty by promoting sustained and broadly shared economic growth.

The Millennium Challenge Account is a key element of the overall U.S. effort to address poverty and development, which must also include existing programs of AID and others to provide humanitarian assistance and famine relief, fight HIV/AIDS, build trade capacity, and provide for economic stability and defense of key partners. We are convinced that the MCA is in our national interest. Greater prosperity in the developing world will alleviate the poverty that breeds discontent and instability. It will expand markets for American exports. It will reduce the spread of disease and pestilence. The Millennium Challenge Account will promote our own security and well-being even as it brings a better life to millions around the globe.

Mr. Chairman, members of the committee, I request your speedy and favorable consideration of the "Millennium Challenge Act of 2003."

Chairman HYDE. Thank you, Mr. Secretary. Mr. Taylor.

STATEMENT OF THE HONORABLE JOHN B. TAYLOR, UNDER SECRETARY, OFFICE OF THE UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. TAYLOR. Thank you, Mr. Chairman, Congressman Lantos, and other distinguished Members of the Committee for inviting me to testify on this very important and innovative program that President Bush has proposed.

The program, the Millennium Challenge Account, is designed to reduce poverty around the world, raise income per capita around the world by raising economic growth around the world. The part of economic growth that is emphasized is productivity growth, the increase in the amount of goods and services that each worker can produce each year, because that is the source of rising incomes and the source of reduction in poverty. Countries that have had high growth rates of productivity have been catching up, have been doing better, have been reducing poverty. Countries with low growth rates, near-zero growth rates of productivity, remain poor, and poverty remains very high.

The Millennium Challenge Account addresses this problem by focusing on policies that will raise economic growth. Those policies, as President Bush has indicated, are policies that represent governing justly, investing in people, and encouraging economic freedom. The Millennium Challenge Account also addresses these problems by increasing funding substantially over our existing programs, and it addresses the problems by insisting on measurable results in every program that comes out of the Millennium Challenge Account.

I would like to focus my oral remarks on the way that the Millennium Challenge Account will address the growth issues and the measurable-results issues. As Under Secretary Larson indicated, an interagency group, consisting of the three people at the table and many others, has worked over several months in consultation with other donors, developing countries, NGOs, universities, think tanks and the private sector to develop some measures of policies that are conducive to economic growth. The policies that have been selected are policies which have been proven, by experience and by statistical studies to raise economic growth and to reduce poverty.

There are also indicators that cover a large number of countries. There are indicators that are transparent and widely available, and there are indicators that are objective and sound. Of course, the indicators are not cast in stone, and they may be changed in the future, depending on how we progress.

As Under Secretary Larson indicated, there is a total of 16 indicators representing the policies of governing justly, investing in people, and encouraging economic freedom. With respect to governing justly, there are a total of six indicators. For example, two come from Freedom House, widely available, studied for a long time, covering civil liberties and political rights. There are also indicators in this category, developed by the World Bank Institute, which cover the rule of law, corruption, good governance, and the voice of people.

With respect to investing in people, there are four indicators, two relating to education and two relating to health. One is the percentage of spending that the government devotes to education as

a share of GDP. Just as important, perhaps more important, a measure of education investment is the completion rate of young children in schools.

With respect to health, again, a measure of spending relative to GDP but also a measure of immunization rates, the effectiveness of health care, and the dedication of a country, of a government, to improving the well being of its people.

With respect to encouraging economic freedom, there is a total of six indicators emphasizing openness to trade, an indicator developed by the Heritage Foundation; emphasizing low inflation, sound fiscal policy, which are also conducive to economic growth; and even measuring the time it takes to start up a business, a very good measure of the likelihood of entrepreneurs creating jobs that raise productivity.

I would emphasize that these indicators are to be used with judgment by the Millennium Challenge Account. There may be missing data. There may be some countries which are improving or not doing so well. That needs to be taken into account. I also emphasize that the indicators are transparent. They are widely available. Many of the indicators are available on Web sites, and others can be obtained more directly from countries.

I would also emphasize that when applying these indicators, there is an effort to distinguish the very poor countries from the middle-income countries, effectively to have two contests or two ways to consider the different countries together, and that, I think, introduces an element of fairness, which is appropriate.

Let me just mention a few things about the measuring of the results, which we are insisting on. We hope that every project or every grant has indicators of success, whether for the whole country or for the program itself. To do this, baseline data has to be established, and, in addition, there will be ways to assess whether the projects are on track or falling behind and to make adjustments if the project is falling behind.

So based on these indicators, measuring the results and the increase in funding, we think the Millennium Challenge Account represents a great opportunity to transform the rhetoric of development effectiveness into an operational action plan that will make a difference, and I urge your favorable consideration of the Millennium Challenge Act of 2003. Thank you very much.

[The prepared statement of Mr. Taylor follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN B. TAYLOR, UNDER SECRETARY, OFFICE OF THE UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Chairman Hyde, Representative Lantos, Members of the Committee, thank you for the opportunity to testify today on the Millennium Challenge Account (MCA). My statement will focus on the economic rationale behind the MCA and how it fits well with the Administration's approach to development.

Today there are more than one billion people living on less than \$1 a day and nearly three billion living on less than \$2 a day. In addition to the tragedy of those living in extreme poverty are those whose lives are claimed by ailments virtually unseen in the U.S. Last year alone 3 million people died for lack of immunization, 1 million died from malaria, 3 million died from water-related diseases, and 2 million died from exposure to stove smoke inside their own homes. In addition, HIV/AIDS has ravaged the populations of developing nations, killing 3 million people in 2002 alone.

The United States is helping in many ways to combat these problems. The MCA is part of the Administration's overall development strategy, as Administrator Natsios and Under Secretary Larson describe in their testimony. The MCA is designed specifically to catalyze the policy reforms that are the foundation of economic growth and poverty reduction.

DEVELOPMENT ASSISTANCE AND PRODUCTIVITY GROWTH

Sustainable poverty reduction can only be achieved via economic growth, which is primarily determined by productivity growth. Productivity is the amount of goods and services that a worker produces per unit of time with the skills and tools available. If you want to reduce the number of countries with low per capita incomes, then you have no choice but to increase productivity in those countries. And the higher the rate of productivity growth, the faster poverty will decline. Simply put, the ticket out of poverty is higher productivity jobs.

Productivity depends on two things: capital per worker and the level of technology. If there are no impediments to the flow and accumulation of capital and technology, then countries that are behind in productivity should have a higher productivity growth rate. They should catch up, and we have seen many countries catching up over the years—such as South Korea, Chile, and Botswana. However, many of the poorest nations still have had low and stagnant productivity and income, and they are not catching up. More and more evidence has been accumulating that this is due to significant impediments to investment and the adoption of technology.

These impediments can be grouped into three areas. First, *poor governance*—the lack of rule of law or enforceable contracts and the prevalence of corruption—creates disincentives to invest, start up new firms, and expand existing firms with high-productivity jobs. This has a negative impact on capital formation and entrepreneurial activity. Second, *weak health and education systems* impede the development of human capital. Workers without adequate education do not have the skills to take on high-productivity jobs or to increase the productivity of the jobs they do have. Third, *too many restrictions on economic transactions* prevent people from trading goods and services or adopting new technologies. Poor economic policies, state monopolies, excessive regulation, and the lack of openness to trade are all examples of restrictions that reduce the incentives for innovation and investment that are needed to boost productivity.

The Administration's approach to assisting developing nations to overcome these impediments and thereby increase their productivity growth is to increase aid, reward better performance, and measure results. All three must be simultaneously implemented; two of three alone would not succeed. As the MCA clearly represents a significant increase in aid levels, I want to focus on how the MCA will reward better performance and measure results.

REWARDING BETTER PERFORMANCE

President Bush's vision of the MCA recognizes the importance of rewarding pro-growth policies. He categorizes these policies as ruling justly, investing in people and encouraging economic freedom. The MCA provides an incentive for countries to adopt good policies that will benefit them in three distinct ways:

- i. These policies, in and of themselves, will increase growth;
- ii. These policies will create an environment conducive to foreign and domestic investment; and
- iii. Development assistance will be more effective in good policy environments.

Following President Bush's leadership, the Administration sought to develop a set of indicators that will be used to measure a country's commitment to pro-growth policies. An interagency group with representatives from Treasury, State, USAID, OMB, Commerce, CEA and NSC worked intensively for several months evaluating a wide range of possible indicators. As part of this process, we met with representatives from other donor countries, developing countries, non-governmental organizations (NGOs), universities, think tanks, the private sector, and other interested parties to gather their ideas.

As a first step we needed to decide which set of countries would be eligible to compete for MCA funds. Our proposal is to expand the number of countries eligible as funding ramps up. In FY'04, 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. This is currently 74 countries. In FY'05, all countries with incomes below \$1,435 will be considered, which adds another 13 countries. In FY'06, all countries with incomes up to \$2,975—the current World

Bank cutoff for lower middle income countries—will be eligible to compete as a separate pool. This group currently consists of 29 countries. It is important to note that countries prohibited from receiving assistance by current statutory restrictions will not be eligible.

Eligible countries will qualify for funding based on their policy performance in the categories of ruling justly, investing in people and encouraging economic freedom. In an attempt to objectively quantify performance in these three categories, we considered a variety of potential indicators. Ultimately, we selected 16 based on their relationship to growth and poverty reduction, the number of countries they cover, their transparency and availability, and their relative soundness and objectivity. These indicators are not set in stone and may change in the future if problems with them emerge or better indicators become available. To qualify as a better performer, a country will have to be above the median on half of the indicators in each of the three policy areas.

Governing Justly:

There is a growing literature on the importance of strong political institutions and good economic governance to successful development.

1) *Civil Liberties*: Freedom House evaluates freedom of expression, association and organizational rights, rule of law and human rights, and personal autonomy and economic rights.

2) *Political Rights*: Freedom House also evaluates the prevalence of free and fair elections of officials with real power; the ability of citizens to form political parties that may compete fairly in elections; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies and economic oligarchies; and the political rights of minority groups.

3) *Voice and Accountability*: The World Bank Institute has designed a set of indices that aggregates existing quantitative assessments of governance from a broad range of sources. One of these indices attempts to measure a country's ability to protect civil liberties, the extent to which citizens of a country are able to participate in the selection of governments, and the independence of the media.

The policies incorporated in the previous three indicators should be seen as ends in their own right apart from their impact on growth. Additionally, freedom of expression and of the media allow civil society to effectively monitor the government and reduce corruption and more subtle rent-seeking behavior. Free and fair elections make governments accountable to the entire country rather than to a narrow power base, thus making them more responsive to development needs.

The remaining three indicators are produced by the World Bank Institute. These indices are formed by aggregating surveys from 15–20 different sources, similar to Voice and Accountability:

4) *Government Effectiveness*: Good governance includes the provision of quality public services, civil servants who are competent and independent from political pressures, and credible governments that make good on their commitment to produce and implement sound policies and deliver public goods.

5) *Rule of Law*: This index attempts to measure the extent to which people have confidence in and abide by rules of society, the incidence of violent and non-violent crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.

6) *Control of Corruption*: With respect to this indicator, President Bush made it clear that MCA funds should only go to the most transparent and least corrupt countries. To meet the President's concerns, we have determined that those countries which fall below the median on this indicator will be considered ineligible for MCA funds, absent material change in their circumstances.

Investing in People:

In terms of measuring a country's commitment to educating its citizenry and providing basic health care, we were particularly concerned that a country's income level not preclude it from qualifying, yet we also wanted to provide an incentive for countries to focus on key policies that contribute to growth. Our proposal, therefore, includes two budgetary input measures, which governments can control and rapidly change. However, more money does not always lead to better results. Consequently, we have included two output measures that more accurately reflect improvement in the policy environment over time and are key to sustainable development.

1) *Public expenditure on health as a percent of GDP*: These data are being provided directly by the recipient government.

2) *Immunization rate for DPT and measles*: The UN's World Health Organization publicly compiles and annually releases data on immunization rates for nearly all member countries. Immunization rates can be associated with growth because labor

productivity increases when workers are not out sick or caring for ill family members.

3) *Total public expenditure on primary education as a percent of GDP*: These data are being provided directly by the recipient government.

4) *Primary Completion Rate*: The World Bank and UNESCO compile data that measure whether children are attaining minimum education levels. A higher level of education increases labor productivity.

Encouraging Economic Freedom:

The MCA will measure a country's level of economic freedom based on its performance in implementing prudent macroeconomic and microeconomic policies, as well as creating the conditions necessary to attract investors.

1) *Country Credit Rating*: Institutional Investor magazine produces a semi-annual survey of bankers' and fund managers' perceptions of a country's risk of default. Our belief is that such a survey is an important indicator of the views of the private sector. In addition, an improved credit rating usually leads to a lower cost of capital and greater domestic and foreign direct investment.

2) *Inflation*: High inflation distorts relative prices and discourages long-term investments. Also, as the poor hold a higher percentage of their wealth in cash, they are disproportionately hurt by the erosion of their purchasing power. Of the 16 indicators, this is the only one where performance is not judged relative to the median. Instead, a country must have inflation of less than 20% in order to pass the indicator.

3) *Budget Deficit / GDP*: As a measure of fiscal policy, we use a country's overall budget deficit averaged over a three-year period. The data for this measure will be provided directly by the recipient government, cross-checked with other sources, and made publicly available. Among other impacts on growth, a high budget deficit crowds out private sector investment and can lead to inflation.

4) *Days to start a business*: The Private Sector Advisory Service of the World Bank Group works with local lawyers and other professionals to examine specific regulations that impact business investment. One of their studies measures how many days it takes to open a new business. Bureaucratic barriers to business formation that go beyond protecting society not only hinder entrepreneurship but may exist to preserve the economic rents of political cronies.

5) *Trade Policy: The Heritage Foundation's Index of Economic Freedom* measures a country's openness to international trade based on average tariff rates and non-tariff barriers to trade. Open economies—those with low to moderate trade barriers and exchange controls—tend to grow faster than more closed economies.

6) *Regulatory Quality Rating*: The World Bank Institute (see section above on Governing Justly) measures the burden on business arising from, among others, licensing requirements, labor regulations, and bureaucratic corruption. Excessive regulations and their arbitrary application deter investment and raise the cost of doing business, thereby hindering job creation and reducing growth.

While these indicators meet all of our criteria, there may still be gaps or lags in the data, or trends not reflected in the data, which may be material for assessing performance. To correct for these possibilities, the MCA Board of Directors will look behind the numbers to make a final recommendation to the President on qualifying countries.

MEASURING RESULTS

Aid effectiveness requires not only better performance but also a focus on measuring results. This is a core component of the Administration's development strategy and is one that we have pushed in the Multilateral Development Banks (MDBs). For example, the U.S. made part of its financial commitment to the IDA-13 replenishment in the form of an incentive contribution that will reward the World Bank for increasing the use of various diagnostic tools (such as reviewing the policies of developing countries in the areas of financial accountability, procurement, public expenditure management, and poverty analysis) as well as making progress towards a set of development indicators (in health, education, and private sector development). The agreement also called for the initiation of a performance measurement system which will develop ultimately into a common set of outcome indicators that can be compared across countries.

The MCA furthers this focus on measuring results by making accountability for results an integral part of every activity for which MCA funds are used. Americans are by nature a generous people but they want to see results from their funds that are devoted to development, and their support for providing foreign assistance will only increase if those results are demonstrated in a convincing and straightforward manner. By measuring concrete results, we can focus our efforts on what really mat-

ters: helping poor people around the world escape from poverty and lead better lives. The approach helps us cut through bureaucratic layers, ignore non-essentials, and concentrate on development problems that must be solved. It is a way to maximize the benefits of our funds.

MCA contracts will state in quantitative terms the expected outcomes of individual activities and overall country assistance. We will require a clear strategy for gathering baseline data and measuring progress towards stated results and assessing the reasons for success and failure. We will also require projects to be structured in a way that steps up or cuts back funding contingent on achieving results. In addition, evaluation of results will allow the MCA to incorporate lessons learned into ongoing and future operations. In keeping with the MCA's commitment to transparency, all monitoring and evaluation reports, as well as the terms of each contract, will be made public in the U.S. and in the host country. Furthermore, we will continue to monitor country commitment to MCA selection criteria.

In addition to sector specific monitoring, we will also be concerned with the broader policy environment. The Millennium Challenge Corporation will monitor overall budget data to determine whether recipient governments are using MCA resources in a complementary manner with their own domestic and other development resources.

Coordination of assistance with other donors will be vital to the success of the MCA. Each recipient country will be responsible for managing coordination among the MCA and other donors to maximize impact and avoid duplication of efforts. The effort to align MCA country contracts and MDB assistance with each country's Poverty Reduction Strategy Paper (PRSP) or other development strategy will also help coordinate development assistance.

CONCLUSION

For many years, we have all heard about the importance of aid effectiveness. The MCA represents this country's greatest opportunity to transform rhetoric into an operational action plan. The MCA has the ability to challenge countries to demonstrate performance, to achieve results, and most importantly to assist their people in having a better opportunity to pursue a better life for themselves and their families. I urge your favorable consideration of the "Millennium Challenge Act of 2003."

Chairman HYDE. Thank you very much, Mr. Secretary. Mr. Natsios.

STATEMENT OF THE HONORABLE ANDREW S. NATSIOS, ADMINISTRATOR, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. NATSIOS. Thank you, Mr. Chairman and Members of the Committee, for holding this hearing on the Millennium Challenge Account in such a timely manner. We appreciate the Committee's excellent work in drafting legislation on such key issues as the global HIV/AIDS pandemic, your work on promoting religious freedom and on famine prevention. We look forward to continued close cooperation with you and your Committee as we move ahead to establish what I believe will be one of the most sweeping developments in foreign aid since the Marshall Plan and the Alliance for Progress. We actually did a careful research of foreign assistance since World War II, and this ranks as one of the three major presidential initiatives since the second world war, from a historical perspective.

I would like to thank Under Secretary Larson and Under Secretary Taylor for their excellent summary of the evolution of the MCA and the key issues and philosophy that stimulated the initiative. USAID welcomes the MCA as a bold initiative that will complement our mission and provide strategic focus to U.S. development-assistance priorities. We see USAID's role as key in President Bush's campaign to attack the scourge of poverty by stimulating economic growth, promoting democracy, and investing in people.

But USAID is only one piece of what is now becoming a coherent and more coordinated United States development strategy. For the first time, we have the opportunity to articulate and implement a U.S. strategy that clearly and accurately defines our different challenges and matches the right tools to address them. MCA will play a critical role in this process as we begin to redefine U.S. development assistance to address the very different challenges we face today than those faced during the Cold War.

I might add that the structure of our whole foreign-policy apparatus was basically established following World War II, between 1945 and 1950, and we have been living off of the innovations created after the second world war. We really did not change a lot in a profound way in the 1990s because it was not clear what our major challenges were. Now it is pretty clear what our challenges are, and the President, through the Department of Homeland Security, through this legislation, and other things that have been initiated, is now restructuring the foreign-policy apparatus for the new era in foreign affairs that we are entering.

I might add that the written testimony I have submitted is not just testimony from USAID on this legislation. We have carefully worked it and researched it and written it to reflect an operational plan for how USAID will interact with this legislation and this new office, should the Congress approve it. I would commend the written testimony as a seminal document in terms of where USAID is going as well.

Specifically, MCA puts into practice what we know works in development. As both Under Secretaries Larson and Taylor suggested, the MCA is the direct outgrowth of what USAID and other development actors have learned over the past 40 years. Put simply, development assistance in poor countries that are pursuing good policies produces growth. We know that good governance, democratic governance, economic policies and institutions are key. Country ownership of the development agenda is also essential.

One of our mistakes, Mr. Chairman, in the last 20 years of development assistance, is assuming people from the outside can force countries to do the right thing when they resist it. The model we have used before is conditionality—that is we say if you do these things, we will give you money. The international banks do this, the U.N. to a lesser degree does this, and we certainly have done it. And the problem with it is countries will take the money, but then they will not make the changes.

So the change in this legislation, the profound change, is we are looking for countries that, on their own, that made the changes needed for growth and stability, and then we reward those countries that, on their own, have decided to take the right path from our perspective. These are the foundations of the MCA.

We also know that money alone will not correct bad policy. The fact that it is not the quantity but the quality of aid that counts was at the heart of the debate in Monterrey. We know that throwing money at a problem or meeting official development assistance (ODA) quotas is not the answer. The MCA recognizes that foreign aid can, at best, play a supporting role in a country's development, but a country's commitment to help itself is the primary determinant of success. This is particularly true of governance. Experi-

ence has taught us that no amount of money can overcome corrupt, predatory, tyrannical, local leaders or the absence of the political will to reform.

I might add here, the MCA has already become an extraordinarily powerful tool in countries that are not going to be eligible. I have had Prime Ministers, Speakers of Parliaments, Presidents of countries come to see me and say, "We know we are not going to be eligible, but we are now using this to overcome the forces of opposition to reform within our own society because we are telling people the reason we are not eligible is we have refused to make these changes."

One recent example, from last week—I will not tell you the country; I do not want to embarrass them—the speaker of the house came to see me, and I said, "You know, you are on the edge. You are probably not going to make it; but you are right on the edge, but you have a terrible problem with corruption."

There are four bills that the USAID mission helped the ministers draft that have been in the congress in that country for 3 years, unapproved because they threaten powerful vested interests, and I said, "It is a clear indication your people are not serious about cleaning up corruption in your country." I asked our mission director in that country last week, did this have any effect on him. He said it has caused a furor in the capital city because the speaker of the parliament went to the President and said, "Do you know why we are not qualifying? It is because we did not clean up this mess of corruption, and if we had passed the legislation and implemented the legislation, we might be getting this enormous increase in foreign aid."

That is an example of the effect it is having in countries that may not become eligible except for some period in the future.

USAID will reorient its assistance programs to take into account the principle driving the MCA. We welcome the MCA as the strongest possible commitment by the Administration to making development a core element of our foreign policy. Not only does it embody the right philosophy and approach to development but it also gives USAID the opportunity to clarify its role and better focus its activities within the context of a coordinated U.S. development strategy. Given our strong interest in and supporting and complementing the Millennium Challenge Corporation, USAID has begun reviewing its own portfolio to determine the best way to organize itself, both to support the mission and operations of the MCA and to fulfill our mandate to help a wider range of developing countries.

In addition to providing support that may be needed in MCC countries, we believe USAID should focus activities on four broad categories of countries. The first are countries that just missed getting into MCA. They are countries that are on the edge, but they did not quite make it in this first round, depending on how the indicators are at any given time because they change depending on new data that comes in. The second are mid-range performers with a will to reform that are trying, but they are pretty far away from qualifying, and the third are failed or failing states that need post-conflict transition or humanitarian assistance. Mr. Chairman, we now spend \$2 billion on these countries, and we have reorganized

aid around a bureau that deals with failed and failing states as its principal mandate. Roger Winter is the head of that bureau.

And then there are, finally, countries that require continuing assistance for strategic, national-security interests. The first group of countries—these are the countries that are near misses—will concentrate on the specific areas that require strengthening for MCA eligibility. For example, if a country is not investing sufficient resources in its health care system or its education system to qualify, USAID would concentrate its programs in that area.

And in the second group of countries, which are unlikely MCA candidates in the near future, we will need to assess the commitment to political and economic reform. Where such a commitment exists, we will concentrate on building local capacity and institutions that can support the foundation of MCA's assistance over the longer term. For those countries that lack such a commitment, we will continue programs that address such global issues as HIV/AIDS and environmental degradation but will need to review other assistance as well.

Right now, we do not make our assistance for humanitarian purposes for failed and failing states based on national performance. We base it solely on need. On countries that have terrible health crises, we do not go in and say, "You are not managing your democracy very well; therefore, we are going to shut down all of your HIV/AIDS funding or your child-survival funding or your nutrition funding." That should not be done based on the national government's performance. But in development assistance, that third category of assistance in USAID, we do use that now to make judgments, and this will be even more aggressively and rigorously driven forward by this legislation.

The third group of countries, as I mentioned earlier, are failed and failing states that are not even remotely close. Some of them do not even have national governments. Somalia has not had a national government since 1991. There is no country to coordinate with because there is no government. But we have restructured USAID programs around this, and we have an almost 50 percent increase in the last 2 years in the account for failed and failing states. We are not abandoning those countries. We are putting more resources in.

We have created a new office of conflict mitigation and management to focus on these countries, most of which are failing for governance reasons. We moved the democracy and governance function, the office that does that technically, into this bureau because there is a connection between state failure and the failure of democracy and governance in that country and the failure to deal with civil war.

Finally, USAID will continue to respond to needs in countries of strategic national importance or transnational threats, recognizing that the primary objectives typically fall under our foreign-policy and national-security strategies and may not necessarily produce economic growth or reduce poverty. We will work quickly, flexibly, and effectively to achieve overall U.S. Government objectives.

MCC programs will be founded on a partnership and driven by country demand. We stand ready to adapt programs to support the MCC. If a country selected for MCC funding has a USAID mission

and a program, we would undertake a strategic review of the existing portfolio of projects. In many cases, we would see the USAID program transitioning to support the MCC contract. However, there are critical global and regional threats, such as HIV/AIDS, that would warrant continued support with or without the MCA.

Indeed, one of the ways that USAID will complement the MCC is that we have the ability to address regional issues. The MCA is country focused. USAID has many regional programs, and we will continue those because we have a value addedness [sic] in that area in particular.

Thus, the point I would like to leave with the Committee is that we will not adopt a black or white approach on how we will relate to MCC in every country; rather, we will think each country through on a case-by-case basis.

Mr. Chairman, I believe the President's vision for assisting the developing world, as embodied in the MCA, creates a unique opportunity to prove that development done right can work, and we urge the passage of the legislation. Thank you very much.

[The prepared statement of Mr. Natsios follows:]

PREPARED STATEMENT OF THE HONORABLE ANDREW S. NATSIOS, ADMINISTRATOR,
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Thank you Mr. Chairman and Members of the Committee for holding this important hearing on the Millennium Challenge Account (MCA) in such a timely fashion. We appreciate the excellent work of this Committee in drafting legislation on such key issues as global HIV/AIDS, tuberculosis and malaria, your work on promoting international religious freedom, and on famine prevention. We look forward to continued close cooperation with you and your committee as we move ahead to establish what I believe is a revolutionary new development initiative.

I would like to thank Under Secretary Larson and Under Secretary Taylor for the excellent summary of the evolution of the MCA and analysis of key issues and philosophy that stimulated the initiative. I will focus my remarks on three key areas: (1) how the experience of USAID and other development institutions has shaped the MCA; (2) how we see the MCA complementing the work of USAID and refocusing USAID priorities; and (3) our vision for how the MCA will be implemented in the field.

I would like to preface my remarks by underscoring two points made by Under Secretary Larson. The first point is that the process for developing the framework for the MCA and the legislation has truly been a model of interagency coordination. Thanks to the active involvement of key departments and agencies, we were able to coalesce the comparative advantages of those parts of the government already deeply involved in bilateral and multilateral assistance programs. The State Department coordinated outreach with key international and domestic constituencies; the Treasury Department, which has responsibility for the multilateral development banks, played a central role in developing the indicators; USAID, based on its extensive field experience, offered ideas and proposals on the framework and implementation of the MCA. Together, our ideas have been drawn on, and in many cases adopted, as fundamental principles of the proposed new account.

I would also like to underscore the point that we need to see the MCA as only one piece of an unprecedented and concerted commitment of President Bush to increase and improve the effectiveness of foreign assistance. It began with his efforts to forge a new international consensus on development at the Monterrey Financing for Development Conference a year ago and the proposal for the MCA. At the heart of that consensus is that the donor countries will work to mobilize more money for development, while developing countries take more responsibility for creating a sound policy environment. Last month the President submitted a budget to Congress requesting a dramatic increase in the 150 account of development and humanitarian assistance from \$7.7 billion in Fiscal Year 2002 to over \$18 billion by Fiscal Year 2008. Much of that increase will go toward urgent crises, such as stemming the global HIV/AIDS pandemic. But it also includes as much as \$20 billion for MCA, beginning with \$1.3 billion in Fiscal Year 2004 and stabilizing at \$5 billion per year

by Fiscal Year 2006. It is clear that this Administration has taken development off the back burner and placed it squarely at the forefront of our foreign policy.

From the perspective of USAID, the MCA is a welcome and bold initiative that will complement and provide a model for our mission. We see USAID's role as key in the President's all-out campaign to attack the scourge of poverty by stimulating economic growth, promoting democracy and investing in people. But USAID is only one piece of what is now becoming a more coherent and coordinated United States development strategy. For the first time, we have the opportunity to articulate and implement a U.S. strategy that clearly and accurately defines our different challenges and matches the right tools to address them. MCA will play a critical role in this process as we begin to redefine U.S. development assistance to address the very different challenges we face today.

THE ROOTS OF THE MCA

The MCA symbolizes a dramatic turning point, both in putting into practice what we know works in development and in elevating development as a fundamental aspect of our foreign policy. As both Under Secretaries Larson and Taylor suggested, the MCA is the direct outgrowth of what USAID and other development actors have learned over the past fifty years. We not only have considerable first-hand experience about what has worked and what hasn't, but we also have the benefit of considerable recent analysis by the World Bank and leading analysts that support this experience. Put simply, economic development assistance in poor countries works best when you are pursuing good policies that are conducive to growth. We know that good governance, policies and institutions are key; real country ownership is also essential. And we know that performance must be measured using rigorous and unbiased indicators. These are the foundations for the MCA.

A recent World Bank paper summarizes the key themes of what has become a consensus among development specialists worldwide: "The collective record of the past yields three main lessons. First, good development outcomes require good policies and institutions. Second, if development progress is to be sustained, the underlying policies and institutions must be country-owned and country-specific. Third, when these conditions are in place, development assistance can be highly effective." The MCA criteria of good governance, economic freedom, and sound investments in people are indicative of the policies and institutions that determine a country's development success.

We know that money will not solve the problem of bad policy. The fact that it is not the quantity of aid that counts, but the quality, was at the heart of the debate in Monterrey. We know that throwing money at the problem, or meeting "ODA quotas" is not the answer. The MCA also recognizes that foreign aid can, at best, play a supporting role in a country's development; a country's commitment to help itself is the primary determinant of success. We know that private capital flows far outweigh development assistance, and that in the age of globalization, developing countries can undertake reforms that value private trade and investment for development.

We believe a key aspect of persuading countries to improve their policies or institutions is to provide the right incentives. This is why USAID actively promotes the principles of rewarding performance rather than promises, rewarding good governance, establishing local ownership, civil society and private investor participation, and streamlining the assistance delivery process, all of which are reflected in the MCA.

I want to highlight in particular the critical importance of governance. The emphasis on governance in the MCA reflects a fundamental lesson we have learned through hard experience; no amount of money from afar can compensate for or overcome corrupt local leaders or the absence of political will. Overcoming poverty and fostering growth requires governments to become more transparent, inclusive, lawful and responsible to their citizens. Money can't buy this commitment or these kinds of reforms. There needs to be the will to actually pursue these goals. These kinds of reforms, however, can be supported, encouraged and even reinforced by rewards for governments that are moving in this direction. Good performers should be tangibly rewarded with increased development assistance from the international community, incentives for foreign investment, and trade liberalization. Democratic, accountable governance with responsible economic policies should bring immediate and sustained benefits.

To be sure, some East Asian states have contained corruption and achieved rapid development under authoritarian rule. But worldwide, these states have been the exception. Over the past two decades, the two most rapidly developing countries in Africa have been the only two African states to sustain democracy continuously

since independence, Botswana and Mauritius. Recent research shows that institutions and policies explain most of the variation across countries in economic development, with property rights, control of corruption, civil liberties, and political rights all significant factors accounting for development success. It has been found that at every level of national development, fewer infants die in democracies than in dictatorships. But actually linking aid to development performance is a radical step. This is one of the reasons why MCA marks a revolution in foreign assistance. Because MCA countries and institutions will have demonstrated capacity to achieve results, the new Millennium Challenge Corporation (MCC) will be able to employ a new way of doing business that relies on host country institutions to manage development activities.

RELATIONSHIP TO USAID

The revolution does not stop with the MCA. It has just begun. The themes of the critical importance of governance and country ownership, the emphasis on performance and accountability, must infuse all of our development assistance. That is why, working under the inspired leadership of Secretary Powell, we initiated a series of reforms at USAID two years ago. We knew that the major changes of the past decades had dramatically altered the landscape for development and that we needed a new direction for U.S. foreign assistance, and hence produced the recent report, *Foreign Aid in the National Interest*. We took up the challenge of drawing these lessons together to begin to formulate the outline for a new framework for US foreign assistance.

We had already begun making some of the changes in USAID suggested by the report, incorporating lessons learned, such as making governance an essential cross-cutting theme, and adopting strategic budgeting approaches as we reorient ourselves and adapt to the current challenges. USAID, however, is only one piece of the picture of USG foreign assistance. As you well know there are numerous U.S. departments and agencies—the State Department, the Treasury Department, the Department of Defense, the Peace Corps, to name only a few—that all have different roles and objectives in providing assistance. Putting these different pieces altogether, many of them with very diverse mandates, is no small task. Indeed, the MCA is the cornerstone of putting America's foreign aid back in order: renewing the focus on economic growth, integrating the nation's foreign affairs expertise, and mobilizing new resources for development.

This is why the MCA, which has boldly and forcefully articulated a new vision for development—with the resources to support it—has such a critical role to play in stimulating and focusing the debate on foreign assistance. Not only is it driving the debate in the United States, but it has also grabbed the attention of our international colleagues, who are all watching the progress of the MCA with great interest. It presents all of us who care about development with both a strong challenge and a historic opportunity. It gives us a clean slate to make the case to the American public and the international community that development is critical to global stability and that it can work.

To those who have questioned whether USAID feels threatened by the MCA, I would answer, to the contrary. We welcome the MCA as the strongest possible commitment by the Administration to making development a core element of our foreign policy. Not only does it embody the right philosophy and approach to development and potentially provide a model for development, but it also gives USAID the opportunity to clarify its role and better focus its activities within the context of a coordinated U.S. development strategy.

We view the MCA as our leading edge, targeted on spurring growth in the best performing poorest countries, providing the level of resources that can really make a difference in moving them to a higher growth trajectory. It will rely on country institutions—investors, business people, political leaders and civil society—to design and lead the economic growth of the country. But MCA, due to its strict criteria, will only assist a limited number of countries. That leaves the large majority of the developing world to USAID and other agencies and actors.

Given our strong interest in supporting and complementing the Millennium Challenge Corporation, USAID has been reviewing its portfolio to determine the best way to organize itself both to support the mission and operations of the MCC and to fulfill our mandate to help a wider range of developing countries. In addition to providing support that may be needed in MCA countries, we believe that USAID should focus activities on four broad groups of countries: (1) countries that just miss getting into the MCA; (2) the mid-range performers with the will to reform; (3) failed or failing states that need post-conflict, transition or humanitarian assistance; and (4) countries requiring assistance for strategic national security interests.

I would like to highlight our belief that the central objective of focusing on performance, particularly responsible governance, and focusing on good performers must infuse all our development efforts—not just the MCA—and those of other bilateral and multilateral donors as well. This is the way that MCC can serve as a model for all of our assistance programs.

In the first group of countries, USAID will concentrate on the specific areas needed to help a country become eligible for MCC funds. For example, if a country just missed on the investing in people area, USAID would concentrate its programs in that area to help it qualify for MCC funds in a future round. In the second group of countries which are unlikely MCA candidates in the near term, we will need to assess the commitment to political and economic reform.

Where such a commitment exists, we will concentrate on building local capacity and institutions that can support the foundation of MCA assistance, i.e., ruling justly, promoting economic freedom, and investing in people. For those countries that lack such a commitment, we will continue programs that address global issues such as HIV/ AIDS and environmental degradation, but will need to review broader development assistance. We are already beginning this process of applying an MCA lens to our country programs, informing resource decisions with analysis of democracy and sound governance.

In the third group USAID has responsibility for countries and situations that do not lend themselves to assistance guided by MCC criteria, such as in failing, failed and conflict states. As the National Security Strategy states, “America is now threatened less by conquering states than we are by failing ones.” Fully two-thirds of the countries where USAID works have suffered violent conflicts within the last five years. We know that conflict is complex and that interventions must focus on multiple dimensions. We are actively developing new assistance models that will integrate emergency relief and food with transitional assistance, governance investments and civil society building. We must approach these states with targeted, flexible support that emphasizes conflict prevention and the nesting of short, medium and long-term issues in our program designs.

Humanitarian assistance also remains central to USAID’s portfolio. Originally designed to respond to natural disasters, humanitarian interventions are increasingly necessitated by complex emergencies caused by conflict, failed and failing states. We restructured our humanitarian assistance to create a new Bureau of Democracy, Conflict and Humanitarian Assistance to make sure that democracy, governance programs, conflict, mitigation and prevention are at the heart of our response to failing states. We have also increased our funding levels to nearly \$2 billion. Recognizing the need for greater flexibility in responding to humanitarian emergencies and failing states, the President requested a new contingency fund to facilitate the quick response that is critical in complex emergencies.

Finally, USAID will continue to respond to needs in countries of strategic national importance or transnational threats recognizing that the primary objectives typically fall under national security and foreign policy more than development. These political challenges will continue to arise, frequently related to the war against terrorism. As much as possible they are funded out of Economic Support Funds (ESF) or other assistance. USAID will work quickly, flexibly, and effectively to achieve overall U.S. Government objectives.

In addition to adapting our programs to support and complement the MCC, there are of course other ways that we will be working closely with the MCC. Foremost will be detailing staff to the Corporation. We view the long experience of USAID’s development professionals as an invaluable asset to the new corporation. As I will outline below, we also envision that USAID support to the MCC in the field will be required, given the lean staffing currently envisioned.

On the broadest policy and programmatic level, I expect to coordinate closely with the CEO of the MCC, given our complementary roles. This will be paralleled by coordination on a programmatic level. While some have questioned whether the establishment of the MCC doesn’t complicate our development efforts, I would suggest that today’s reality is already a complicated one. There are many actors involved in development. The addition of the MCC, which brings such significant and welcome new resources applied to the best development practices, has the opportunity to bring greater strategic focus to our entire development framework.

IMPLEMENTATION

Turning to the question of how the MCA will actually be implemented in the field, I need to preface my comments by saying that very few of the details have been worked out. However, I will try to lay out a very broad vision for you of how the MCC might work, subject to revision, once we get the Corporation up and running.

MCA programs will be founded on a partnership and be very focused on one or two key strategic objectives that the country has identified as their top priority to stimulate growth. In order to develop a proposal, we are asking countries to engage in a consultative process with all the relevant civil society and private sector groups. One of the central principles of the MCA is that it be a transparent process from start to finish. This is why it is important that the initial phase of developing a country proposal set the tone and foundation for the development partnership. While the process may vary considerably from country to country, the themes of transparency and country leadership and ownership of the proposal are critical.

In some cases, technical assistance may be required to help a country develop a proposal, which the MCC could offer. However, the country will be managing the process; it will not be a case of the MCC hiring consultants to develop a proposal it wants.

If a country's proposal is selected, a country contract would be negotiated between the MCC and government. This does not imply that those funds will only go to the government. To the contrary, it is anticipated that MCC funds will go to a variety of national and community actors and alliances. However, the government will sign the agreement with the MCC and have overall responsibility for managing and overseeing the contract. The reason we chose a contract approach is to underscore that both parties have an obligation to meet the terms and conditions outlined in the contract.

We anticipate that MCC funds will mobilize a variety of economic actors in each country; to the extent that a development result requires a public sector investment (schools or roads), funds would be channeled through the government. However since economic growth inevitably depends on the activities and investments of the private productive sectors, community groups and civil society organizations, we expect that these institutions would also participate, and even implement the bulk of the investments. In all cases, we expect that MCC funds would be disbursed directly to the institutions implementing activities under the MCC contract through the most flexible, but accountable mechanisms.

If a country selected for MCC funding has a USAID mission and program, we would likely undertake a strategic review of the program. In many cases, we would see the USAID program transition to support the MCC contract. Some programs, such as those fighting HIV/AIDS or trafficking in persons, might well be continued, while others might logically be phased out or incorporated in the MCC program. Indeed, one of the ways that USAID will complement the MCC is that we have the ability to address regional issues, such as disease, water resources, transport linkages, etc., that the MCC, by virtue of being country-specific, cannot.

One of the basic premises for implementation of the MCC is that it should be demand-driven. We do not want to prescribe the mechanics of how activities would be implemented. I would anticipate that it will vary considerably from country to country, knowing there are no "cookie-cutter" approaches that will work across the board. However, the goal will be to employ simple implementation mechanisms that require less oversight and less U.S. management than traditional projects. There are a variety of mechanisms for spending the funds, such as contracts or grants, but these could be managed by the host country, following their policies and procedures.

Because the management approach of the MCC will be to employ local institutions for country development, it is appropriate that the MCC, too, rely heavily on strong local institutions for the in-country expertise it requires. Economic and financial analysis of specific MCC investments can be contracted locally. Technical advisory services to the MCC can be contracted locally. Monitoring and evaluation can largely be contracted locally. Therefore, we anticipate that the full-time presence of US government employees needed to manage the MCC can be significantly reduced.

Even though we envision a strong reliance on local institutions, there will still be a need for limited MCC staff presence in the field to facilitate, manage and oversee the partnership. Due to the limited staffing, we anticipate that the Ambassador and Embassy staff will play a strong supportive role of the MCC. We also believe that USAID field staff, with its development expertise and knowledge of local culture and context, will play a key role in supporting the MCC.

USAID presence in the field has rightly been repeatedly recognized as its strongest suit. Thirty years of development experience has taught us that country context matters a great deal. I can imagine that our very capable field Missions could provide critical support to the MCC, helping to work with local partners, finding creative, local solutions to problems, and generally facilitating the work of the MCC. The basic USAID activity in many of the likely MCA countries has been knowledge transfer and building local capacity and institutions. In some cases, continued USAID programs in institution building may be necessary for a time to further

build country capacity to manage MCC programs and resources. As I have tried to emphasize, while I believe USAID will have a key role in supporting MCC programs, we do not want to adopt a black or white approach to how USAID will relate to the MCC in every country; rather we think each country will need to be reviewed on a case-by-case basis.

CONCLUSION

As I mentioned earlier, there are many practical details to be worked out, which the CEO and MCC need to be involved in and will be best equipped to solve. However, I think we have developed a strong vision of key principles for the MCC. I began by saying that we believe the MCC marks a revolution in the U.S. approach to development assistance. It will help clarify the mission and objectives of foreign assistance, it will provide greater policy coherence by integrating foreign policy expertise, and it will mobilize more resources to help make development truly sustainable.

Spurred by the proposal for the MCC and the changes in the developing world, we are forging a better understanding of foreign assistance and its numerous different goals—the developmental goals, the humanitarian goals, the policy goals, trade-related goals, security goals, etc. We are beginning a process of articulating these goals and matching them with appropriate resources and programs, and developing a strategic approach to US foreign assistance.

For USAID, the MCC has the potential to provide a great model. It is a golden opportunity to prove that development, done right, can work. I urge your favorable consideration of the legislation and look forward to working with you in the weeks ahead.

Chairman HYDE. Thank you, Mr. Natsios. We will now open the floor for questions, and I would plead with my Members to confine your statements and questions to 5 minutes so we can maximize the opportunity for questioning by every Member. Mr. Lantos.

Mr. LANTOS. Thank you, Mr. Chairman. I want to commend all three witnesses for very excellent testimony. I shall quickly raise some issues, and whoever wishes to answer them is free to do so.

I would like to get an answer to the funding question. The President proposed \$1.7 billion. The current proposal is \$1.3 billion.

Secondly, we have just been through a rather difficult and painful process of merging the United States Information Agency and the Arms Control and Disarmament Agency into the State Department. We are now in the process of proliferating agencies. Now, I understand in the academic world there is a whole industry which moves from quarter system to semester system, and the value of it is that people have to redo their notes when they move from one to the other, and that makes for fresher teaching.

But I really would like some rational explanation as to why, as we have just been through the process of consolidating agencies operating in the international field and, with enormous turbulence and difficulty, merged the United States Information Agency and the Arms Control and Disarmament Agency into the State Department, we are now not using an agency in the State Department but creating this new entity. On the face of it, it is a nonsequitur, and I hope someone will try to explain it to me.

Thirdly, I see practically no involvement with respect to congressional oversight in the proposal. There is a minimal role in appointing the head of the agency, and that is it, and I think you are smoking something very powerful if you think congressional oversight will not be part of this legislation.

Next, I would like to ask you to react to the 16 criteria. It is self-evident, and here I speak as a professional economist, that the less developed the country, the less dependable the statistics. So to look

at 16 sets of statistics involving 100 countries and to pretend that we are getting precise measurements of their eligibility is sheer lunacy. We are really kidding ourselves if we assume that 16 criteria globally, for every country, from Central Africa to Central America, can give us eligibility criteria, it boggles the mind because it simply in the real world will not happen.

And, finally, I deeply deplore the lack of any reference in the proposed legislation to the role of women. Women constitute about 70 percent of the poor. There is systematic discrimination against women in many of the countries which are potentially eligible. Women should and can play a critical role in development, and I would like to suggest that the legislation, as it evolves, recognize the enormous significance of placing special emphasis on the role of women in this whole process.

Mr. LARSON. Mr. Lantos, I would like to just take a very quick crack at each of the important points you raised, and I am sure my colleagues can help.

The President's approach on funding was to suggest that we ramp up over 3 years to a level of \$5 billion per year for the MCA and that that level continue over time. While there were some illustrative numbers in fact sheets and so forth, I do not believe that there was a firm plan for exactly how that ramp-up would take place, and it has been our view that we are going to need to walk before we run, that 2004 will be a startup year and that \$1.3 billion would be a very good amount to—

Mr. LANTOS. Am I dreaming in remembering that the figure mentioned for the first year was \$1.7 billion? It is all right for me if you say they decided to cut it back by \$400 million, but do not give the impression that the \$1.7 billion figure was not part of the initial announcement.

Mr. LARSON. I do not know if it was part of the initial announcement. I do know that there was an illustrative fact sheet that showed a way of ramping up that was a straight-line ramp-up, and I suspect that is what you are referring to. But, again, what I wanted to stress in that the proposal is that in this first year the MCA would focus on the lowest-income tier, that is, countries below 1445 that are eligible to borrow from the concessional arm of the World Bank, and so it would be a very considerable amount and, I think, appropriate for a startup year.

Secondly, you raised the issue of the structure and the corporation. I think the response that I would give is that, first of all, USAID, as Mr. Natsios has laid out, is getting more responsibilities rather than fewer, both more budget and a stronger role on things like HIV/AIDS, fighting famine, and so forth. It has been the Administration's view that this program is so targeted, that it is so important for this program to operate outside of earmarks, that it is so important for it to have flexible contracting authorities and flexible authorities for personnel management, that it would be most efficient to set it up as a separate corporation.

Mr. LANTOS. This is a very unsatisfactory answer, as you know as well as I do. I mean, if the present structure is not functioning well, then we should change the present structure, not leave the impression that the present bureaucratic structure is all right for what we are now doing, but now we are going to create a more effi-

cient, new organization. I mean, nobody can buy this. It is either better, in which case USAID should have the same new, streamlined structure, or we are merely proliferating, but you cannot have it both ways.

Mr. LARSON. It is different. I would not say it is better or worse, but it is different, in that it is so focused on growth-promoting projects in countries that have demonstrated commitment to good policies. It is not trying to do all of the things that Mr. Natsios explained about humanitarian assistance, about working with countries who have terrible health problems, and things of that sort.

You mentioned, sir, congressional oversight. I can tell you that the Secretary of State, in every conversation that he has had with me and his cabinet colleagues, has stressed the importance of congressional oversight and accountability and that his view is that, as Chairman of the board of directors, his primary responsibility will be to have that chain of accountability to the Congress, to the American people to show that this program is producing the sort of results that you and me would expect.

On the indicators, we do not view them as something that would be applied mechanically. What we do think is that this is a real effort to be open and transparent, both to the Congress and to the American people, about what is informing judgments about participants in this program but also to other countries. All three of us have seen already that our ability to say that here are some very specific things that will not decide but will inform decisions has had a catalytic effect on developing countries and gotten them to focus on areas of policy weakness.

Finally, your point about the role of women, I think, is a very good one. I think, to some extent, this is captured by some of the indicators. It is also captured by the proposal in the Administration fact sheets that we would like to see, and we would expect to see, our partners have a participatory process by which they establish their development priorities and by which they come up with the development activities on which they want to partner with us. And so this notion of broad-based citizen participation from all segments of society is part of the plan.

Mr. LANTOS. Thank you.

Chairman HYDE. Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman. Gentlemen, thank you very much for your testimony. As all of you know, over a billion people currently struggle to survive on a dollar a day. According to the International Fund for Agricultural Development (IFAD), roughly three-quarters of them live and work in rural areas, and over half depend upon farming or farm labor for their livelihoods. Agriculture-related activities are also pivotal in generating employment, promoting broad economic growth, and preventing food crises and famine, yet global aid to agricultural development has declined significantly in recent decades.

The MCA proposal, which establishes agricultural development as a key focal area, offers a welcome sign of U.S. leadership in reversing this trend.

Now, with those preparatory comments, I have two questions on that basis. First, several organizations, such as IFAD and the Consultative Group on International Agriculture Research, as well as

various NGOs and land-grant institutions, have long focused on agriculture. How will the MCA make use of those organizations' considerable expertise in targeting this critical area?

And, secondly, it would seem that an integrated rural development strategy would also extend beyond agriculture and take account of critical cross-cutting issues, such as gender and HIV/AIDS. How will the MCA's structure reflect the need to ensure that agricultural or rural-development strategies can address those realities as well?

Mr. LARSON. Let me say a quick word, but I think Administrator Natsios should pick up on this primarily. He and I both were in New York yesterday, Congressman, at a G-8 meeting that was honored by the presence of the Secretary General of the United Nations, and this was about food security, the famine situation in Africa, and the importance of trying to promote a second green revolution in Africa. We think that the MCA, which, as you rightly say, includes a proposed focus on agriculture, is going to be a very important tool to catalyze developments in this area.

The U.N. organizations that were present, and IFAD was present as was FAO and the World Food Program at the very top level, they are working already to develop bankable projects in these areas with countries and to help encourage countries to make agriculture a bigger part of their development strategy. That dovetails very well with what we have in mind under the MCA, and I think both Administrator Natsios and I were extraordinarily pleased that we have been able to get this sort of focus on agriculture at the very top of the U.N. system.

Mr. BEREUTER. How will you make it dovetail with those organizations' efforts?

Mr. LARSON. Well, for example, and Andrew should pick up on this, we expect that the countries have to come forward with the proposals, and it has been commented on that the development of good proposals is something that does take time. There will need to be an iterative process. The fact that IFAD and FAO are already working with these countries to develop ideas is something that actually creates a great deal of spade work, and it makes it very easy for us to partner not only with the country but potentially with these international institutions if they are a part of the country's strategy for expanding credit, for getting firm tenure for land, for example, helping a country use its water better, or introducing biotechnology, which is something that we think ought to be part of an agricultural development strategy.

Mr. NATSIOS. If I could, Mr. Chairman.

Chairman HYDE. Mr. Payne.

Mr. PAYNE. Mr. Chairman, I think Mr. Natsios was going to try to respond yet on my time, if that is all right.

Chairman HYDE. Sorry. I heard a pause, and I thought it was more pregnant than it was.

Mr. NATSIOS. I could not agree more with your comments, Congressman. When Peter McPherson left USAID in 1986 as the Administrator, we were spending \$1.3 billion on agricultural development in the developing world. When I arrived 2 years ago, we were spending \$240 million. We dropped a billion dollars in 17 years, and that does not include inflation. We had 240 agricultural sci-

entists and economists in USAID in 1986. When I arrived, there were 40 left, and many of them were nearing retirement. We stopped hiring in the nineties. We got out of the business.

It was a disaster for the developing world, particularly for Central Asia and Sub-Saharan Africa, which are the two most food-insecure areas of the world. Eighty percent of the poor people in the world live in rural areas, and they are farmers or herders. If you want to attack equity problems in the developing world, family-income problems, nutritional problems, even educational problems, you have to start with the farms, and we are not doing that.

We are beginning to do that again. We increased the agriculture account for Africa in this budget, with the approval of the Congress, by 25 percent. We have doubled the number of agriculturalists in USAID to build back up our staff, so we are rehiring now. It is one of the major new focuses of USAID.

Let me tell you the problem, though. I have not met anyone in this city who says this is a bad idea. Everybody says it is great, but I want more money for the environment, for HIV/AIDS, for child survival, for education. You go through the list, and they say, "We are in favor of all of these things, but these other things are a little bit more important."

That is not our view in USAID. Our view in USAID is unless we focus on agriculture, particularly in Central America, which has still a lot of people in the rural areas who are farmers, and Sub-Saharan Africa and Central Asia, we are not going to make progress against poverty and hunger and instability. A heavy amount of the money we are spending in Afghanistan on reconstruction is in agriculture reconstruction.

Now, the difference with the MCA is the President is insistent that there not be earmarks, because earmarking is what is killing us in terms of what we know needs to be done in Sub-Saharan Africa. If you took a public or private poll with the heads of state of every country in Sub-Saharan Africa, the Prime Ministers, the ministers, the leaders of the NGOs, and the business community, and if you asked them what area we should be spending more money on, it is not the areas we are spending more money on; it is in agriculture. All of them say it. It is because they come from farm families. If 70 percent of your voters were in a rural area, and you are not dealing with agriculture, you are not going to get reelected.

So this is demand driven—that is our intention—it is what the countries tell us they want to do—they will all tell you right now, we want more money in this area. So what we hope is there will be no earmarks. Because if there are earmarks, agriculture is going to lose because the constituency is not powerful enough in this city to overcome the other constituencies for other very legitimate demands that are not quite as much based on what is needed in the developing world.

Chairman HYDE. Mr. Payne.

Mr. PAYNE. Thank you very much. Thank you, gentlemen, for coming here, and I, too, think that it is great that the United States is starting to step up to the plate with additional funding for overseas development. I, too, have some concerns about this new agency and with the number of criteria.

One, I have heard the two other secretaries talk about the failure, I guess, of the monies that we have spent for U.S. assistance abroad. I think that probably one of the reasons that it has not been successful is that there has been so little. Once you have taken out military armaments and those kinds of things, I think there has been very little left in our foreign-assistance budget that has really gone down to helping people.

I just have some quick questions regarding the structure of the MCA. First of all, from what I understand, USAID is not even a part of the board. Is that correct?

Mr. LARSON. That is correct. The proposed board is the Secretary of State, Secretary of the Treasury, and the Director of OMB. AID is represented through the Secretary of State.

Mr. PAYNE. That makes absolutely no sense, none. I am not going to ask the Administrator. Believe me, I am not crazy. I do not want to put him on the spot. That is my opinion.

Number two, the Heritage Foundation is going to make the determination on ruling justly. Now, it is a great think tank but, for example, how would they rule me if I were going to be nominated for Attorney General? I am opposed to the death penalty. The current Attorney General is asking states to step up executions. Many of his people come from the Heritage Foundation. How are we going to then be considered to be ruling justly when the Heritage Foundation is one of the two agencies that will determine where these 100 countries go—and Freedom House? I mean, there are groups like Church World Service, Africare, Oxfam, although it is a foreign organization, and the Red Cross. But you pick Freedom House and the Heritage Foundation. I really would not want to be rated by them if my future depended on it because I would have no future. Why those two, and how are we supposed to deal with ruling justly?

Mr. TAYLOR. Congressman, I will try to address this question. There are a total of 16 indicators that have been proposed. Some of them are from Freedom House. Some of them are from Heritage. The Heritage Foundation indicator that we have of the 16 is for openness to trade, which we think is essential for measuring policies that raise growth, openness to trade. But there are also indicators from the World Bank, from the World Bank Institute. Some of the data are from the countries themselves.

So there is a wide range of sources of the data, and, moreover, the way that we have suggested to use the data is to allow flexibility in the sense that countries would be eligible if they are above the median on half, not all, but half, of the indicators in each of the three categories.

On top of all of that there is judgment. If there are missing data, or there are signs that there are some improvements because of a change in leadership, that flexibility is encouraged. It is judgment, and the accountability for these decisions will lie with the board and with the person in charge.

So it seems to us that we have handled the kinds of concerns that you are raising by having a wide number covering different sources and allowing flexibility in the application.

Mr. PAYNE. Before my time expires, let me just say, then, Uganda has been failed for being qualifying. They qualified for HIPIC

(highly indebted poor countries). Their world's grade has been dropped to 6.5 percent. They have reduced poverty from 56 to 27 percent. Primary education has risen from 40 to 99 percent. Uganda has led the world in reducing HIV and AIDS. It is the model, yet they fail because they do not have a multiparty system. And, you know, we have nonpartisan elections in the city of Newark, where I go. There are no parties. If you do not have parties, does that mean you have a bad system? Maybe it is a nonparty system. It does not have to be a one-party system.

So I think that, first of all, I am glad that there is an interest in trying to increase foreign assistance, but since my time has expired, let me say I think this whole question needs a lot of rethinking.

Chairman HYDE. Mr. Natsios, do you want to add something?

Mr. NATSIOS. Yes. Just let me add a comment on Uganda. It is very intriguing to me that President Museveni, for whom I have great respect, announced a couple of weeks ago that they are going to move to a multiparty system, and they are going to expand civil liberties. It is not in Uganda just a problem of parties; it is also a problem of civil liberties, of freedom of the press. There are other governance problems.

On the economic side and the social-service side, President Museveni is perhaps the leader in Africa. This lack of civil liberties was a weakness, in my view and, I think, for a lot of other people who admired him. He is now announcing he is going to move away from this view. He has various arguments that he has given me over the years, as to why he takes that view, but it is intriguing to me that he announced it just now, with the announcement of the Millennium Challenge Account.

It may be that countries that have been somewhat reluctant to go to wider civil liberties, to deal with some of the democracy issues, are now willing to. Perhaps, maybe not, but perhaps the MCA is helping that discussion, and that is not bad because he is doing it on his own. But the fact is that in the last couple of weeks he just announced that.

So changes are taking place, and one of the things that Secretary Larson mentioned is we need to understand these things are taking place. It may not be reflected in data that might be 2 years old. There has to be some flexibility, but the data have to serve as the basis for the discussion.

Chairman HYDE. Mr. Flake.

Mr. FLAKE. Thank you, Mr. Chairman, and I thank those who have testified. I am still having trouble reconciling the relationship between this new organization and USAID. Mr. Larson, you mentioned that the creation of the MCA will not come at the expense of AID. Now, a lot of us who are concerned about where we are in terms of our budget, in terms of the sluggish economy and the war effort and everything else, wish that it would come at the expense of AID. It is common knowledge, shared by all of you, that AID has not worked as it should, that there is inefficiency, bureaucracy there.

I just wanted to follow up on some of the concerns that have been raised already. Why don't we model AID after this? I understand that AID has some different roles that are purely humanitarian.

No matter how corrupt the government, we still have a humanitarian concern. North Korea; we are shipping food there, for example. But that only represents a small portion of what we distribute through AID, and I am just wondering what this is going to prompt at AID, how much of a change.

We in Congress hear over and over again that we have got to create something new. Why in this case? Why can't we take the funding that goes to AID, take out the humanitarian stuff that is needed or that we would give in any event, and model it after this new system?

Mr. NATSIOS. If I could, Mr. Chairman.

Chairman HYDE. Yes.

Mr. NATSIOS. I do not have the time to read my entire testimony, Congressman. If you read the longer testimony for the record, it goes into some detail on how we will do that.

Let me just sort of subdivide the USAID budget. Two billion dollars of our budget goes for humanitarian purposes. The amount of money we actually spend is about \$9 billion. Two billion goes for the health programs. Four billion dollars goes for primarily foreign policy or national security reasons: Economic Support Funds (ESF), assistance to the former Soviet Union, and assistance to Eastern Europe and the Baltics that are controlled by the State Department but largely managed by USAID. They determine which countries get those funds, and they are for political purposes. They are being used in the Middle East now for strategic purposes. You can look at how we are funding, for example, the Pakistan program or Egypt. Egypt is the largest USAID mission in the world. It is entirely ESF funds. There are no development assistance and no humanitarian funds there, and that is one of our oldest programs.

The program is well run, but it is ESF based, and we do not cut the program back because the Egyptian government does not perform. The funding levels are based on the Camp David Accords of 1979, and there is an agreement, a diplomatic agreement that we do not control how that money is spent. We manage the program for the State Department, and we do what they ask us to do. We are not seeing money wasted, but it is not based on performance.

The fourth area is the development-assistance account, actually our smallest account, which is \$1.3 billion. That is the account where we actually do move money around based on performance in different countries. But it is split up among agriculture, education, the environment, trade capacity building, democracy and governance programs—a whole variety of different programs.

We have come a long way. There have been problems in the past with USAID. I think most of those problems have been dealt with. We have had substantial reforms over the last 2 years, and I have to tell you right now that I am proud of what USAID does. We actually fund programs that show results, and that is how we make our judgments in the development-assistance account. Our health programs are based on need, but we also look at whether they perform well. If they do not, we have to change them.

But the difference for the MCA program is it is just targeted to a small number of countries that will get a large amount of money, and the idea is not to just influence those countries, but countries that did not make it are going to say, "We want to be MCA coun-

tries.” We think it will create an incentive to help the reformers reform the societies that are not quite making it.

Chairman HYDE. The Chair regrets to announce we have three votes on the Floor, and so we will have to recess pending the three votes, and we will return. That is our high aspiration. So we will stand in recess until we return.

[Whereupon, at 11:17 a.m., a recess was taken.]

Mr. BEREUTER [presiding]. The hearing will come to order. As soon as you take seats, we will recognize the next Member. The Chair recognizes the distinguished gentleman from New Jersey, Mr. Menendez, for his questions under the 5-minute rule.

Mr. MENENDEZ. Thank you, Mr. Chairman. I appreciate our witnesses. I had to go to another Committee for votes, but I had the opportunity to read your testimony, and my questions are derived therefrom.

Administrator Natsios, as I read your written statement, I could almost hear the Battle Hymn of the Republic in the background. In that statement, you place the Millennium Challenge Account in very distinguished company, including Truman’s Marshall Plan and Kennedy’s Alliance for Progress, but I would humbly suggest to you that this is no Marshall Plan. If we were at a par with the Marshall Plan, you would be asking for 3 percent of GDP, which would probably put us somewhere on the equivalent of \$300 billion in foreign assistance, but what you are asking for here is \$5 billion. So I would urge us not to overstate what we are doing here.

It seems to me that even at the \$5 billion increase of the next 3 years that at the end of the day that still would have us ranked approximately 22 of the 22 advanced industrialized nations in the world. So I certainly do not consider it a Marshall Plan or an Alliance for Progress plan.

I do have some questions, though, within this context. Number one is, as I understand the Millennium Challenge Account and the standards to be reached, very few countries in Latin America would be eligible based upon the income standards and then the other items, maybe Bolivia, Guyana, Haiti, Honduras. So my first question is, is that the case?

Secondly, while the Administration has talked about this \$1.7 billion, and I understand your answer to that was that that was in some planning document, but actually asked for 1.3, my second question is, in both net and real terms, is this really new money?

Thirdly, I would ask you when the Millennium Challenge Accounts are going to replace or reduce any current need-based aid.

And, lastly, I would just say that I look at what we are trying to do—half of the hemisphere, in terms of the Western Hemisphere, is practically falling apart at the seams. The publics in those nations believe that the American-inspired, economic reform, privatization, and globalization of commerce and investment that their countries engaged in during the nineties is to blame for their misery. Wouldn’t it make sense to raise the cap from the 1435 per capita to enable us to help the very poor nations, such as Colombia or El Salvador, Guatemala, and some of the Caribbean nations, to demonstrate to these nations that we are willing to assist their social sectors while at the same time we are asking them to undergo

the sacrifices required to enter into free trade agreements with the United States?

So those are my concerns in this regard, and I would invite your answers to those questions.

Mr. LARSON. I can give you a very quick answer to the first and the last questions. Under the per capita income levels proposed by the Administration, in the first year five countries from our hemisphere would be eligible; by the second, seven; and by the third year, 15. So just as we propose to ramp up the amount of funding, we are proposing to increase the per capita income cap to what basically includes the World Bank's lower middle-income level of just under 3,000, and that would, for example, catch many of the countries that you are talking about, such as El Salvador, but it does ramp up over time.

Mr. NATSIOS. Mr. Chairman, with respect to net and real increases, this is for fiscal year 2004, so let me go over what our budget is. There were no cuts. There were increases, and the net overall resources available to us for development assistance, food assistance, humanitarian assistance, and the health account for FY 2004 will be over \$3 billion plus an additional \$300 million that the President put into the 2004 budget for USAID. So there is about a 9 or 10 percent increase, if you include these, which are in the budget for 2004.

There is no reduction in our budget for that period; there was an increase. The increase this year that the Administration put forward was very large for FY 2003. It is the largest increase in foreign assistance in the budget, apart from MCA. I have to say that the MCA is only one part of what is happening. The increase of \$2 billion a year, on top of what we are spending for HIV/AIDS, will bring the total spending—it is about a \$3 billion increase from about the level of \$10 billion we are spending now, if you add all of the different initiatives the Administration has requested. They are in the budget for FY 2004.

You asked whether there were any need-based aid reductions. There were not. In fact, there is a substantial increase in the budget for failed and failing states. In fact, that is where the 9 or 10 percent increase came. It was put into the account that deals in failed and failing states because we are not abandoning them. If anything, we are increasing the funding levels for those states that are in serious trouble because we recognize, both on a need basis but also because failed states are dangerous to the national-security interests of the United States. There are much higher mortality rates there. There is much more at risk, and we are actually taking a very aggressive role in strengthening our ability to respond to those initiatives.

Mr. MENENDEZ. Mr. Chairman, I have questions because some of the numbers that I have received and looked at in the context of the budget do not gibe with your answer, so I will submit written questions to you. I would appreciate the answer as soon as possible.

Mr. BEREUTER. With unanimous consent, it will be helpful if you would share those with the Committee, if you are willing.

The gentleman from Michigan, Mr. Smith, is recognized for 5 minutes.

Mr. SMITH OF MICHIGAN. Mr. Chairman, thank you. I guess maybe without getting into the speech-making mode on where we are in deficit spending in approaching \$400 billion, spending more than we have, which means that we are imposing on our children and our grandchildren a tax increase sometime, suggesting that what we do today is more important than what they are going to be faced with when they come up with servicing the debt by paying the interest and paying back the debt.

I guess my question would be, if we were going to limit the overall foreign aid to a 10 percent increase, what areas might you cut back on in terms of a lesser priority? I know you do not want to answer that, but try to give it your best shot.

Mr. NATSIOS. Of course, not. [Laughter.] Mr. Chairman, if I could, I just want to make one general point. I am a conservative, and my voting record will show that in Massachusetts, even though I come from Massachusetts. You might be suspicious of that. [Laughter.]

I believe, if you look at the American economy, the growth in the economy has been very much outside our borders, which is to say we are an exporting country. We import a lot, but we also export a lot, and we also invest a lot of our funds. If you look at the mutual funds, a lot of that money is being invested in other countries in the world.

A stable, peaceful, prosperous, international order is in the long-term interests of our children and grandchildren because if the United States is going to be prosperous, it is going to be prosperous if the rest of the world is prosperous and stable, and the more stable it is, the more globalization advances, the more there is a free-trading system, the more competitive we are going to be. We are the most competitive nation in the world in many respects, and having a developing world that has good ties with the United States, that is tied into our economy in a constructive way, I think is in the interests of our children.

Mr. SMITH OF MICHIGAN. Would you suggest we spend more than what the President is suggesting?

Mr. NATSIOS. No.

Mr. SMITH OF MICHIGAN. So you just feel only so strongly about that.

Mr. NATSIOS. No, but the President has proposed the largest increase in foreign assistance in 40 years, and he did that because we now know, and he says this in a national security strategy, we are not at risk from conquering countries; we are at risk from failed and failing states. Afghanistan had no national government for 10 years. Somalia has not had a national government for 10 years. Sudan has been a failed state for 25 years. That is where al-Qaeda lived, those three countries.

Mr. SMITH OF MICHIGAN. Allow me to interrupt because I have only got a couple of minutes left. If the Millennium Challenge Account that all of you have suggested is such a good approach and a good idea, why are we developing a new management organization structure rather than improving the way AID operates to change their mode of operation to allow—instead of setting up a whole new organization, why is that advisable?

Mr. NATSIOS. Well, one, USAID, when I was in the first Bush Administration, spent 67 percent of what we spend on foreign aid. When I arrived back, under the new Administration, President Bush's Administration, we were at 50 percent. In the 1990s, a lot of other Federal agencies started having international programs, and that is probably not going to change because of the complexity of what we do as a government. Much of that is in technical assistance.

Having a committee of three of the most powerful figures in the Federal Government—the Secretary of the Treasury, the Secretary of State, the Director of OMB—will force coordination in a way that would be very useful in creating an integrated national strategy in foreign assistance, which I think is a visionary thing to do, and I commend the President for it and support the legislation that the President has submitted.

The office we are talking about is not going to run a \$5 billion program. The intention is to have other Federal agencies that have expertise manage many of these programs.

Mr. SMITH OF MICHIGAN. Mr. Larson, what do you see as some of the potential bottlenecks, obstacles in making this program a success the first year?

Mr. LARSON. What I think we are going to need to do in the first year is, very quickly, hire a well-qualified chief executive officer who can manage this program well and assemble a very small but effective staff from the best people we can find within government and outside government, including the business sector and the NGOs.

We are going to have to move through the selection process for countries so that we can, as soon as the Congress makes available the money, be in a position to show that we can make this program work and move very quickly, but I think it will be on the management side standing up this organization, hiring the chief executive officer and a small but competent team of professionals to run the program.

Mr. SMITH OF MICHIGAN. Well, thank you, Mr. Chairman. Let me just conclude by saying, working in the Administration for a little over 4 years, it would be my opinion that there is no agency and no effort that cannot be improved on with greater efficiency, especially at a time that we really are at war, whether it is the war on terror. It is a time that we all tighten our belt, and I would hope that, either through the authorizing legislation or through other initiatives, we work at that belt tightening. Thank you, Mr. Chairman.

Mr. BEREUTER. The gentleman from New York, Mr. Meeks, is recognized under the 5-minute rule.

Mr. MEEKS. Thank you, Mr. Chairman. When there is so much attention and billions of dollars in resources being devoted to fighting terrorism and the potential war with Iraq, we cannot afford in America to ignore the fact that here we are in the 21st century the richest and most powerful nation in the world, yet hundreds of millions of people in the developing world, particularly women and children, continue to live and die each day from structural poverty, epidemic diseases, chronic hunger, and from political and economic and social violence.

While we can all agree that every society must be the ultimate master of its own development and that America is not the sole cause of the world's problems, if we were to honestly look at the impact of some of our domestic, agricultural, and monetary policies on poorer societies, the impacts of our foreign-policy actions on global institutions, like the IMF, the World Bank, the WTO, on poorer societies, what we spend on food aid, development assistance, reducing some of our barriers to trade from poor countries, and now the MCA pales in comparison to some of the harm that we may cause.

Development involves resources, but, more importantly, it involves policies and institutions, and when I look at our development history here in America and the recent history of successful development in places like Korea, Malaysia, India, Brazil, and now, of course, China, two things become clear to me. One, we can talk about development principles and best practices, but there is no one right path or policy approaches to development that fits all countries. Two, none of the countries which are developed today, including us in the United States, or the more recent successful developing countries I just mentioned adopted the kinds of IMF, World Bank, or other kinds of extreme, free-market, policy approaches at their initial stages of development. When we use these reforms as conditions for aid, it seems as if we are paying poor countries to adopt policies which successful development countries did not use. If the MCA perpetuates these flaws in our approaches to assistance, the results could likely be the same.

With that being said, my first question is, on the continent of Africa, do you know which countries does the Administration believe will qualify under the current eligibility criteria?

Mr. LARSON. We do not have a list of countries that will qualify because the data is constantly being updated, and we are going to have to do those assessments at a later stage. In addition to that, we do feel very strongly that at the end of the day the selection of countries cannot be based solely on indicators because the Congress cannot summon an indicator to come up and give an account of itself. It is going to be the board that is going to have to be accountable to you and the rest of the Congress about which countries are being selected.

I can tell you, sir, that as we have run some of these test runs to just get a feel for what tends to emerge from the application of these indicators, you do tend to get 10 to 12 countries, a substantial number of African countries, obviously, of low income because we have set the bar at 1445 per capital income or below.

If I could just add one quick comment on your comment about trade policies, I would agree with you, and one of the things that Mr. Natsios and I did yesterday, as I said earlier, was to organize a U.N. meeting where there was a lot of focus on what should be done globally to bring down trade barriers for developing countries, and that really is the thrust of our proposals under the DOHA development agenda.

Mr. MEEKS. Let me ask, because I have not heard anything yet with reference to how the money is going to be disbursed, is it all going just to the national governments? Will some go to local municipalities or to the states or anything of that nature so that some-

times if it goes into what you talk about here, the national government, it might not reach the states or reach the local municipalities? Are there any proposals about how the money is going to be disbursed?

Mr. LARSON. First of all, it would be disbursed on the basis of country proposals that the United States also believes in. It should come as a result of a participatory process within that country. We have identified six examples of areas that we think are economic-growth drivers that we would be open to proposals in. They include agriculture, health and education, governance, small business, and trade-oriented activities, but those are only meant to be examples.

We have felt we should be very open in terms of implementing agencies in country and outside country. We would not want to work in a country where we did not believe the national government was committed to development, but we are certainly very open to working through NGOs or local governments, depending on the project.

Mr. BEREUTER. The young lady from California, Ms. Lee, is recognized.

Ms. LEE. Thank you, Mr. Chairman. Let me just say, initially, when I read about his Millennium Challenge Account and the proposal by the President, I was cautiously optimistic. The more I learn about it, though, the more I wonder and have so many questions. Maybe I can just try to summarize a couple of them.

First of all, from the testimony today, it appears that this is going to be another corporate effort and that primarily U.S. companies, which is okay, will benefit and make some profits out of this. Fine. One of the issues that I have always been concerned with, and I know the Congressional Black Caucus has been concerned with, is the involvement of minority- and women-owned businesses. I think Mr. Larson indicated they are going to contract out quite a bit of the service aspect of this. African-American, Latino, Asian-Pacific Islander companies have had a very difficult time just dealing with USAID, and I am very aware of that. Now, how do you intend to involve a more diverse business base in the Millennium Account efforts? Let me just ask you that first.

Mr. LARSON. First of all, I think that, while we recognize very strongly the importance of business in development, we are also emphasizing social investment like health and education and projects like agriculture that probably are not going to bring profits for U.S. companies in the short run but will promote development that can produce opportunities in the longer run.

Secondly, on the contracting, the basic point that the Administration has made is that there ought to be total flexibility to contract to acquire the needed services in the most efficient, possible way for benefit of the developing country and the efficiency of the program.

Ms. LEE. But when we hear "total flexibility," that means end runs around minority businesses.

Mr. LARSON. It means that, whether one is talking about the personnel policies, contracting policies, or earmarks for other programs like Mr. Natsios was talking about, all of these things are valuable; but if it is totally earmarked in advance, you get tied up

in knots. We would like to give this entity flexibility to operate in a way designed to best achieve the goals of the program.

Ms. LEE. How do you ensure the full participation by minority-owned companies in these efforts?

Mr. LARSON. Our experience is that minority-owned companies, particularly if we are working in areas like Africa and Latin America, have tremendous value added, tremendous skills, tremendous entree, tremendous capabilities to provide the sorts of services we are looking for on a competitive basis.

Ms. LEE. And so those decisions would be made by whom in terms of the flexible contracting practices?

Mr. LARSON. The CEO.

Ms. LEE. The CEO would make those decisions. Okay.

The next thing I want to ask you is, in terms of the eligibility and criteria standards that have been laid forth, it is my understanding that think tanks, such as the Freedom House and the Heritage Foundation—and I have a copy of a newsletter by the Heritage Foundation—they have set forth much of the criteria that the MCA will follow. Can you tell me a little bit about that, if that is the case, and how did think tanks in our country become involved in making eligibility criteria, unless I am wrong in what I am reading?

Mr. LARSON. The President set out three broad criteria: Is a country governing justly, is it investing in its own people, and is it creating an environment that is friendly to the enterprise and entrepreneurial efforts of its own citizens? The question then became how do you really assess that, and one could have said, well, let us just make it on the basis of our judgment, or let us have an interagency committee that decides how to assess a country in those three areas.

The more we discussed this, the more we thought there was great value in having a process that was much more transparent, that was based on publicly available indicators, not determined because you do have to have an element of judgment, we believe, at the level of the board, but where our own people could have confidence about what were the sorts of values and indicators and criteria governing decisions and so that it could be a real, transparent process for the developing countries themselves. If, as Mr. Natsios was saying, there was a country that was looking pretty good but had a very significant shortfall in an area, you could point to them and say, "This is the area that has really been a problem for you."

So it has been on the basis of having open, transparent criteria that we thought it was useful to work on these 16 indicators and look for places where there were publicly available indicators.

Mr. BEREUTER. A brief followup question.

Ms. LEE. Well, how about think tanks that involve more people of color and African-Americans and Hispanics and Asian-Pacific Islanders in the think tanks? I know that Freedom House and the Heritage Foundation are not very diverse, and I would think, if you are going to make criteria for developing countries and Third World countries, that the diversity in America should be reflected in the criteria because those are the countries that you are dealing with, those that have cultural roots.

Mr. LARSON. We also are relying on organizations like the World Bank Institute and some of the social indicators. We have also made clear, these indicators are not set in stone. They represent our best effort to search the public domain for indicators that got at the three broad criteria the President set out, but we are going to have to continue to refine those, and some may be scrapped; others may be refined.

Ms. LEE. Thank you, Mr. Chairman. We will present to you some more from our point. Okay?

Mr. BEREUTER. The gentleman from California, Mr. Schiff, is recognized.

Mr. SCHIFF. I thank the Chair. I have two questions, one very specific and one much broader. The specific question is about the criteria that will be used in one particular region—I want to inquire about the possibility of Armenia qualifying under MCA—and a concern that has been raised regarding other foreign-aid decisions to give greater preference to countries like Azerbaidzhan or Georgia for strategic reasons than an historic ally like Armenia that has really demonstrated in the three area of criteria considerable strength.

So one question is how Armenia would be viewed in this, but the broader question I have is, I think this is a very interesting idea, a very interesting concept, outside the box. It has a great deal of promise for those countries that meet the criteria. But I think there is also a need, and probably a greater need, for a category of countries and regions that are not within the parameters, will never qualify for MCA and, in light of September 11th, are a much greater priority for the United States right now, and that is regions like the Middle East, like Central Asia, South Asia, East Africa, where most of the countries that we would be concerned about do not have a record of governing justly, are not investing in their people, are not promoting economic freedom. If there were any area where we were going to be making a major new initiative, it would be directed, I would think, at these regions that are so much breeding grounds for dangers to this country.

What I am interested in is whether there is any applicability of MCA to this broader challenge that we face? If there is not, is there any initiative, which, in my view, should not only be of equivalent scale to the MCA, which targets a different niche, but really much broader scale. I have been an advocate of developing a Marshall-like plan not based on the Marshall Plan, which was for a different era and a different set of problems and dealt with a skilled work force, countries that had, at least, histories of democracy, but something of that level of investment, of ingenuity, of buy-in on the recipient country's part. What are we doing of an equivalent nature or greater nature to address those regions that plainly will not qualify under MCA?

Mr. BEREUTER. Is your mike on?

Mr. LARSON. Armenia's per capita income is such that it would be eligible to compete for MCA funds, subject to the process that we have been describing today. On the more strategic aspects, I can tell you that the Secretary of State's view is that it is important for the MCA to focus on developmental outcomes and that there are many other programs available to him and Mr. Natsios

that can help us deal with the important strategic challenges of the sort that you are describing. The Secretary, for example, just recently outlined the Middle East Partnership Initiative. I think Mr. Natsios, though, can tell you a little bit more about what we are doing on issues like failed states.

Mr. SCHIFF. Before we leave Armenia, given that they have demonstrated they meet these criteria but are also the subject of a boycott, which we do not support, they seem to be a good, compelling candidate for inclusion in this area, but on the broader question.

Mr. NATSIOS. We reorganized USAID in 2001, and without going into all of the details of it, one of the aspects or the objectives of the reorganization was to create a bureau that was focused on failed and failing states. That is their mandate. It is the Bureau of Democracy, Conflict, and Humanitarian Assistance, and we put the democracy and governance technical office in that bureau, created a new office on conflict mitigation and management, and we took the old humanitarian tools available and married them with the governance issues, the democracy issues, and the conflict issues. And they are reorganizing the way they do their work to focus attention on these states that are unstable and sliding into chaos or have no national government, as Somalia has not had for 10 years now. In Afghanistan, the Taliban was in control, but they were not a government in the classical sense of that term. They did not have a government there for many years.

It is not an accident that al-Qaeda had three countries it had presence in: Somalia, Sudan (another failed state), and Afghanistan. These failed states are a threat to the United States, but they are also in terrible humanitarian crises, and we have reorganized ourselves and increased the funding levels by 40 or 50 percent over the last few years in those areas. We are not going to abandon them. We are increasing resources, and we have reorganized so we have more tools at our disposal to help those countries because we agree very much, Congressman, with your analysis that we need to focus attention on these countries. But the MCA is not designed for those countries.

Mr. BEREUTER. The time of the gentleman has expired. The other gentleman from California, Mr. Sherman, is recognized.

Mr. SHERMAN. I join my colleague from California in pointing out the importance of section 907, and that a country that blockades a friend of ours should not be getting aid under this program just because they meet some of the more technical tests laid out in it.

I applaud the Administration for their idea of spending more on helping the poorest countries in the world. It is the right thing to do morally. It is the right thing to do strategically. But as the gentleman from New Jersey pointed out, it is no Marshall Plan.

We should be doing more, but the gentleman from New Jersey, and this is just a technicality perhaps, indicated that we, even if we adopted this plan, would be 22nd out of the 22 rich countries that provide aid. That gives those other 21 countries far too much credit. They are spending virtually nothing in some cases on world stability, whether it is in Europe or in East Asia, whether it is near the border of Japan or on the same continent as Germany. The United States is providing stability in Bosnia. The United States is protecting South Korea from attack. And so we should be looking

at Japan and Germany and others to spend 2 or 3 or 4 percent of their GDP on foreign aid, just as we spend that amount on the combination of foreign aid and world security.

I join with the gentleman from Michigan in wondering whether, in our efforts to spend more money, that means we need more organizations. I think this Committee should focus on whether the MCA should be administered by existing organizations, but I want to focus on the standards by which countries would qualify.

First, on the details, I do kind of wonder whether the Heritage Foundation's grade of a country should be that critical in determining whether it obtains American aid, whether *Institutional Investor* magazine should be looked to, and perhaps we can find other, more government organizations to give us an indication as to whether a country is promoting economic freedom. And we should also remember that political freedom requires that the definition of promoting economic freedom not fit into a purely American definition. If a country wants to provide health care for all of its citizens, that should not be regarded as somehow imposing economic tyranny on its people.

What I want to focus on most with our witnesses here is the fact that we have three standards—governing justly, investing in people, and promoting economic freedom—and as I understand it, a country would have to pass all three of those tests. I am seeking perhaps the support of others on this Committee for an amendment that would provide four standards and say that if a country passes three out of four, they would be eligible, and that fourth standard is cooperation with the United States in the war on terrorism.

How did we sell the American people on the Marshall Plan or the Alliance for Progress? We mentioned that it was part of American national security, part of the effort to defend ourselves from Communism. How are we now going to go to the American people and say, here is a great new plan to help the world; that it explicitly ignores the war on terrorism; that your fear as parents, that your collection of duct tape and plastic sheeting, just put those out of your mind, September 11th never happened; and that when we decide which country gets money, we'll use that duct tape and that plastic sheeting to hide from the American people whether a country allowed the FBI to come in to try to find terrorists or said, "Oh, we are sorry, that raises too many domestic, political concerns;" whether a country allowed our planes to fly over their territory or whether it said, "Sorry, that is politically unpopular;" whether Pakistan helps us capture Kalid Sheik Mohammed or whether they tip him off, whether Pakistan votes with us in the United Nations or not; all to be ignored, that the safety of Americans in their homes is explicitly ignored and given less input than what *Institutional Investor Magazine* has to say about a country's policies?

Mr. BEREUTER. The time of the gentleman has expired.

Mr. SCHIFF. That is going to be difficult. I do not know if we have time to hear a short response from our witnesses.

Mr. BEREUTER. I do not think that calls for a response.

Mr. SCHIFF. Thank you.

Mr. BEREUTER. Thank you. The gentleman from Texas, Mr. Bell, is recognized.

Mr. BELL. Thank you, Mr. Chairman, and I would like to thank the panel. I got to hear your opening statements, and I apologize for having to be out of the room for a lot of the testimony.

I wanted to discuss with you for just a moment the eligibility criteria and the impact that it might have. I am sure you all have looked at it, and I am curious as to how many countries could be disqualified under the proposed eligibility criteria.

Mr. LARSON. We have run a number of approaches at this, and you tend to get something on the order of a dozen, and that reflects the fact that you are asking them to show strong performance in each of the three broad areas that the President highlighted: Governance, social investment, and economic freedom.

Mr. BELL. A dozen could be impacted?

Mr. LARSON. You get about a dozen in the first year, when the President's proposal is that you would focus only on countries that are so poor that their per capita income is under \$1,445, and they also are eligible to borrow from IDA, the soft-loan window of the World Bank.

Mr. BELL. Could it go higher, because in one of the estimates I had seen prior to today's hearing the estimate was quite a bit higher than 12?

Mr. LARSON. Well, as the scope of eligible countries would grow in the second and third year, one would expect that the number of countries that become eligible would also grow, perhaps roughly double, but, again, those are rough estimates based on preliminary work.

Mr. BELL. How would the process work, then, in the future if a country was attempting to requalify?

Mr. LARSON. One of the real goals of this program is not to divide the developing countries into two camps but to encourage those who do not quite qualify to address the areas that have prevented them from doing so. Mr. Natsios highlighted the role that USAID would expect to play in helping countries with weak areas in their performance so that they could, in fact, qualify, and I think it is this sensitive factor that is one of the most appealing aspects of the program.

Mr. BELL. I understand that it came up earlier in the hearing, but I was not here for your responses, as to the role of women in development and the proposed legislation basically being silent on that point. Has there been any discussion to revisit that subject?

Mr. LARSON. The subject is addressed in a couple of different important respects. One, the various indicators that deal with things like political rights, voice and accountability, civil liberties all get at least some aspects of gender equality and rights of women, and these are part of the indicators that help inform a judgment about whether a country really meets the present standards of governing justly, for example, and investing in their own people.

Another way in which this issue comes in is that we have said that we expect that any participating country, if it comes forward with a project, would do so on the basis of a participatory process in their country that is open to all elements of society. We know, and Andrew can speak more expertly and eloquently to this than I can, but we know how important women are in developing countries. They are the real engines of development at the family level,

so that is very much in our minds as we think about the sorts of investments that we would want to make under this program, whether it is in agriculture or education.

Mr. NATSIOS. Let me, if I could, just add one comment to that, Congressman.

Mr. BELL. Please do.

Mr. NATSIOS. The most important factor in the developing world for the improvement in the political rights, participation, influence, and investment in women in any society is education, particularly primary education. You will note a substantial improvement in child nutrition without any other inputs if a woman has a sixth-grade education. Child mortality rates are much higher for women who have not gone through school, and that goes for high school and on into college. It is sort of intuitive that that is the case, but it has also been the case in developed countries.

So one of the key indicators is the proportion of the gross national product countries are spending on education.

Mr. BELL. Is it primary education or all?

Mr. LARSON. Primary.

Mr. NATSIOS. Primary education. That indicator is an indicator that has a profound influence on the role and influence of women in this society, and since it is primary education, getting girl children through school through the sixth grade is a critical reason why we are increasing by 100 percent our spending in primary education in AID but also why we put this in the indicators. We want to put indicators that will tell us based on performance because right now many of us support this. We have it integrated into our programs, but in terms of finding indicators, general development indicators, that will improve the standard of living, the power, political authority of women, we want to find those indicators that are very clear and very easy to measure, and that is one of them.

Mr. BELL. Thank you.

Mr. BEREUTER. Thank you, gentlemen. That should complete our questions for the first panel. Secretary Larson, Administrator Natsios, thank you very much. I want to thank Secretary Taylor as well. We look forward to working with you on the Committee level in the weeks to come, and thank you very much for your testimony and responses to our questions.

I would like to call now the second panel and ask them to expeditiously take the witness table, please. As they do that, I would like to begin their introductions. The first member of the panel I will introduce is Reverend David Beckmann, President of a Christian citizens movement, Bread for the World, and its research arm, the Bread for the World Institute. An organization numbering 46,000 members and including 2,000 churches, Bread for the World works to promote action to reduce hunger, both domestically and internationally, successfully improving the Food Stamp program and Temporary Assistance for Needy Families (TANF) program nationally, and leading to the international effort to reduce hunger and poverty in Africa, among many other international endeavors. The institute's reports have demonstrated dramatic progress against hunger in the United States and worldwide. I am proud to introduce him as a native of Lincoln, Nebraska.

Our second panelist is Dr. Steven Radelet, who is a Senior Fellow at the Center for Global Development, where he works on issues related to foreign aid, developing-country data, economic growth, and trade between rich and poor countries. Dr. Radelet has served in both government and the private sector, notably as Deputy Assistant Secretary of the Treasury for Africa, the Middle East, and Asia from the year 2000 to 2002. Prior to that time, he served on Harvard University's Institute for International Development, where he directed its macro-economic program and lectured on economics and public policy.

Our next panelist is Dr. Charles MacCormack, who, since 1993, has been President, CEO, and member of the board of the Save the Children Federation, a nonprofit, child-assistance organization which works in 18 states and more than 40 countries to help children and families improve their health, education, and economic opportunities. Also currently a member of the Council on Foreign Relations, Dr. MacCormack was previously President of World Learning, an organization working to foster world peace through international education.

And last, but certainly not least, our panel is joined by Brett Schaefer, a Research Fellow in international regulatory affairs at the Heritage Foundation. An authority on Third World debt and economic-development organizations, Mr. Schaefer keeps a critical watch on the activities and achievements or failures of such organizations as the United Nations, the International Monetary Fund, and the World Bank. In addition to economic-development issues, Mr. Schaefer analyzes foreign policy issues ranging from treaties to trade and economics and specializes in the politics and economies of Sub-Saharan Africa and the Middle East.

Gentlemen, we look forward to your testimony. I am afraid that may be a vote. They will let me know soon, but we may as well start. As Chairman Hyde mentioned initially, the statements of all witnesses will be made a part of the record, and we will begin with a summary of your statement, Reverend Beckmann.

**STATEMENT OF REVEREND DAVID BECKMANN, PRESIDENT,
BREAD FOR THE WORLD**

Mr. BECKMANN. Thank you to the Committee for moving promptly on this issue and for the chance to testify. The Members of this Committee and lots of other people have been working for a long time to improve the amount and the quality of development assistance to poor countries. I think it is mainly a moral issue, but the terrorism has convinced many Americans, including President Bush, that the persistence of massive hunger and poverty around the world is also a national security issue, and so the President is proposing this dramatic expansion of poverty-focused development assistance mainly through the Millennium Challenge Account.

There are a lot of things going wrong in the world right now, but this proposal gives us an opportunity to achieve on a bipartisan and durable basis an increase in what our government is doing to reduce poverty and hunger around the world.

The Committee has strong support from the people of this country. The polls show that Americans are increasingly concerned about global engagement, that they are concerned about the effec-

tiveness of foreign aid, that they want our government to do effective things to reduce poverty, hunger, and disease in the world. Last summer, we polled specifically on the MCA and described briefly the MCA proposal, and 78 percent of voters said they supported that idea.

Bread for the World and Interaction are co-chairing a coalition of 40 diverse, nongovernmental organizations—religious bodies, development agencies, labor unions, environmental groups, think tanks. All of us are mobilized to help get the MCA established in a way that will be really effective in reducing poverty. My own organization, Bread for the World, with our members and churches, will mobilize about a quarter of a million letters to Congress this year in support of the MCA proposal. We have been able to get endorsement from President Jimmy Carter for Bread for the World's campaign in support of President Bush's proposal.

I want to make two requests of the Committee. First, I just really appreciate the promptness of your work on this issue. My first request is that the Committee try to work in a bipartisan way on this issue. It would be great if we could start with a bipartisan bill, but if the bill that emerges from Committee has bipartisan support, it will be a lot easier for us to mobilize a very broad constituency to, in fact, move it through Congress and get it funded. It will also mean that the MCA and the decision that is being made this year about increasing development assistance are more likely to be durable.

Second, I would ask the Committee to take into account the suggestions of the NGO coalition that Bread for the World is part of. The Administration has already incorporated some of our ideas into their legislative proposal. Mr. Bereuter, I was particularly gratified at the prominence of agriculture in the Administration's proposal. That has a lot to do with your work over the years. But the NGO coalition does have some ideas about ways to improve on the Administration's proposal.

We think the MCA should be limited to IDA eligible countries, just the poorest countries. We think that the MCA should be administered by AID, that you could give it the kind of flexibility it needs within AID, or at least that there should be strong legal mechanisms to ensure collaboration. It is the Millennium Challenge Account; we think the MCA legislation should explicitly reference the millennium development goals. That would tend to pull it toward the kinds of investments that benefit poor and hungry people. Finally, we think the legislation needs stronger language to mandate the involvement of local civil society, especially women and disadvantaged groups, in planning and implementation.

These suggestions come out of our experience working in poor countries. They also come out of our experience in working with Americans across the country. We think these suggestions would make the MCA more effective. And if you take into account these suggestions from the groups that are ready to campaign around the MCA, we can direct our energy into helping to move the legislation and getting it funded over the next few years. Thank you very much.

[The prepared statement of Mr. Beckmann follows:]

PREPARED STATEMENT OF REVEREND DAVID BECKMANN, PRESIDENT, BREAD FOR THE WORLD

Thank you for holding this hearing and for giving Bread for the World an opportunity to testify.

I am enthusiastic about the proposed Millennium Challenge Account (MCA). The MCA can be an important step forward in reducing world hunger and poverty and achieving the other Millennium Development Goals (MDGs).

Bread for the World is a grassroots, Christian citizens movement. Our 46,000 individual members and 2,000 member churches care deeply about hunger and poverty here at home and around the world. They mobilize to help improve policies that affect poor and hungry people.

Every member of Congress will be hearing from Bread for the World members this year about the Millennium Challenge Account. We expect to mobilize about 250,000 letters to Congress on this issue. Congress will also be hearing from a broad coalition of religious, humanitarian, development, labor, civil rights and research organizations that Bread for the World co-chairs with InterAction. To give you a sense of the breadth of this coalition, it includes religious groups such as the Episcopal Church, the U.S. Conference of Catholic Bishops, National Council of Churches/Church World Service; development organizations such as Catholic Relief Services, Oxfam America, Save the Children, World Vision, World Learning; labor unions such as AFL-CIO; other broad coalitions such as the Basic Education Coalition, the Women's Edge Coalition and the U.S. Campaign for Global Leadership; conservation groups such as the Audubon Society; and research organizations such as the International Center for Research on Women and the Center for Global Development. A briefing paper from this coalition and a full list of its members is attached to this testimony. Many of these groups have worked together in the Jubilee coalition for debt relief and in various efforts to increase poverty-focused development assistance.

Members of this committee have also worked for a long time to increase the amount and effectiveness of U.S. development assistance to poor countries. For Bread for the World members, development assistance is a moral and religious issue. President Bush's proposal to create the Millennium Challenge Account is recognition not only of the urgent need, but also of increased awareness that reducing poverty and hunger worldwide is important to U.S. national security.

Bread for the World's organizers have been traveling the country since last fall to mobilize our network to speak out on the MCA. We are finding enormous support across the country for an increase in poverty-focused development assistance. Concerned people at the grassroots throughout the country are energized about the Millennium Challenge Account and will get behind the necessary authorizing legislation and appropriations.

I hope you can develop bipartisan legislation on the MCA and incorporate suggestions from our NGO coalition. That would make for a better MCA design, and it would also help us focus constituency interest on getting Congress' approval and funding, rather than on questions about how the MCA will be designed. This grim time has created an opportunity to build a durable consensus for the U.S. to do more to reduce poverty and hunger in the world, but to be durable the consensus clearly needs to be bipartisan.

The world community could make rapid progress against hunger, poverty and disease in the world. The world has made progress on these issues, and we know a lot about what works. Progress is feasible and affordable. The nations of the world have even come to agreement on key indicators of global development—the Millennium Development Goals.

In September 2000, 189 nations, including the United States, affirmed the international development goals in the United Nations Millennium Declaration. These goals reflect over a decade of deliberations at various U.N. conferences and meetings among international development agencies. The MCA proposal was part of the administration's response to the question posed at the U.N. conference in Monterrey, Mexico, last spring, about how to finance the actions needed to achieve the Millennium Development Goals.

The MCA proposal immediately engaged the interest of many NGOs. From the beginning, our coalition has shared our thinking with the administration, and I am happy to see that some of our concerns are reflected in the administration's legislative proposal, particularly about the need to build local ownership, to involve local civil society and to coordinate with other donor countries.

We have an opportunity here to reach millions of poor people through effective development assistance, but it must be done right. The NGO coalition proposes the following principals:

The MCA should be focused on reducing poverty and increasing economic growth. Economic growth is a necessary but not sufficient condition for poverty reduction. Reducing poverty also requires substantial investment in areas such as basic health, primary and secondary education, access to clean water, rural development and smallholder agriculture, microcredit and institution building. Thus, we welcome the goal statement in the administration's legislative proposal. We also appreciate the prominence of agriculture in its list of sector emphases. But we think the legislation should specifically reference the MDGs. Using the MDGs as the framework for making funding decisions and measuring progress would help ensure that poor people truly benefit from the MCA.

The MCA should not be used for political purposes. We learned during the Cold War that aid that is driven by strategic purposes is unlikely to reduce poverty. There are other accounts within the foreign assistance budget for supporting allies in the war against terrorism or war against Iraq. We are pleased that the administration's legislative proposal does not make a country's support for U.S. foreign policy a criterion for support from the MCA.

The MCA should be focused on the poorest countries, that is on IDA-eligible countries only. The administration plans to expand the pool of countries that is eligible for MCA assistance in the second and third year to all low income countries and lower middle income countries respectively. While there is significant poverty in these countries, they have access to other sources of financing. IDA-eligible countries are limited in their access to funding. Expanding the pool of countries would reduce the amount of assistance available to the poorest countries.

Funding for the MCA should be in addition to current spending on core development and humanitarian accounts. In other words, the MCA should not take money away from poor people in countries that do not qualify for the MCA, but rather should serve as an incentive for countries to improve their policies.

Some funding should be provided to those countries that miss eligibility by one indicator. MCA funding can help borderline countries improve in their weakest areas and in future have full access to MCA assistance. That would allow the MCA to help a larger number of poor people.

The authorizing legislation of the MCA should detail how its implementing agency will ensure country ownership, civil society participation and donor coordination. The administration's legislative proposal says that the MCA countries will define how they will use MCA assistance and how they will involve civil society in decision-making and implementation. This makes a lot of sense, but the legislation should more clearly mandate broad-based civil society participation, including gender and ethnic diversity. Women's participation is essential to progress against poverty, so gender measures should be included in the design, implementation, and evaluation of the MCA. MCA assistance should, in many countries, include support for strengthening participatory processes. The legislation should mention that some country agreements will be based on national development strategies or Poverty Reduction Strategy Papers.

The MCA should complement the development work of other U.S. government agencies, notably USAID. The MCA will provide added assistance to those countries that have demonstrated a commitment to their people and to reducing poverty, but this should be additional to—and complement—what USAID does to promote development in countries that are still struggling to meet the eligibility requirements of the MCA. Surprisingly, there is no mention of USAID in the administration's legislative proposal. If the Millennium Challenge Account is not implemented by USAID, USAID should certainly be represented on the Millennium Challenge Corporation's board, and the legislation should mandate collaboration with USAID. While the proposed MCC would allocate funds to countries, much of the MCA support should probably go through USAID and other existing development agencies.

The MCA should be subject to congressional oversight. The legislation should stipulate reporting requirements.

These are the main issues that have been raised by the NGO coalition. They reflect our grassroots experience in low-income countries and the sentiments of many grassroots citizens in this country.

This is a difficult time for our nation and the world. Lots of things are going wrong. But one opportunity we have is to win a bipartisan and durable commitment to do more to reduce hunger and poverty in the world. I'm grateful for your leadership on the MCA and other development assistance issues.

NGO ISSUE BRIEF
 THE MILLENNIUM CHALLENGE ACCOUNT AND U.S. FOREIGN ASSISTANCE
 MARCH 3, 2003

Overview

In March 2002, President Bush pledged new resources to fight global poverty through a “Millennium Challenge Account (MCA.)” New funds would be added starting in 2004 and leading to a \$5 billion annual increase above current foreign assistance levels by 2006. According to the President, funds would go to selected countries that govern justly, invest in the well being of their people and encourage economic freedom. The President also indicated support for a set of internationally agreed upon goals for the halving of poverty around the world, including substantial improvements in health and education in developing countries by 2015. These are known as the Millennium Development Goals.

The Millennium Challenge Account represents a unique opportunity to revitalize and redefine foreign assistance policy of the United States and to maximize the impact, effectiveness and coherence of our aid programs. It will have a critical effect on the way development is carried out in the years to come by the United States and other donor nations. However, the design of this new initiative and its relationship to existing foreign aid programs are not yet clearly defined. Congress will play a key role in further shaping of this initiative as it considers authorizing legislation and ultimately appropriates resources for the MCA and other foreign assistance programs. This paper represents a summary of the views and issues raised by a coalition of non-governmental organizations engaged in international relief and development. The paper is consistent with the coalition’s legislative proposal and with InterAction’s White Paper on the MCA and reflects the research and analysis done by many diverse organizations in the development community.

Purpose of the MCA

The President has indicated that the goal of the MCA will be “to reduce global poverty through increased economic growth.” The President has indicated that the objective of the MCA is to reduce poverty, and he made it clear that a major reason was that “prosperity and opportunity . . . help defeat terror.” While there is ample evidence that sustained economic growth is essential to poverty reduction in developing countries, it is also clear that economic growth by itself does not guarantee poverty reduction. The MCA must not only promote economic growth but also assure that the opportunity to share in the benefits of that growth is available to all, particularly the very poor. Achieving a just, equitable pattern of economic growth and human development has important implications for the type of investments to be financed by the MCA. Therefore, MCA assistance should target poverty—focused development—advancing the Millennium Development Goals in the poorest nations. These goals provide a broad framework for the MCA, including the parameters for the sectors that the MCA should fund.

Country Eligibility

Income thresholds: As proposed by the Administration, MCA funds would initially target low-income countries (annual GDP per capita up to \$1435) and expand to include lower-middle income countries (annual GDP per capita up to \$2975) by 2006 and beyond. While there are many poor people in these countries, there are compelling reasons for the MCA to target low-income countries:

Low income countries have much greater needs because they are on average much poorer and have much worse social conditions than do lower-middle income countries (average annual GDP per capita of \$460 versus \$1965; average adult illiteracy rates of 33 versus 14 percent; and average infant mortality rates of 69 versus 27 per 1000 live births).

Lower-middle income countries have better access to other financial resources. Low-income countries receive less private capital (8.7 versus 10.3 percent of GDP); have much less capacity to raise tax revenue (12.6 versus 21.8 percent of GDP); and are able to save only half as much as lower-middle income countries (8.4 versus 16.2 percent of GDP).

The lower-middle income countries include many countries of strategic importance to the United States. These countries already receive the largest share of U.S. economic and security assistance.

Indicators: Using publicly available indicators to select MCA countries is generally sound in that it offers a potential for transparency and fairness in the selection process. There are several details of the criteria and selection process, however,

that have potentially negative implications for the number and types of countries eligible for MCA funds.

For the three categories established by the President—investing in people, economic freedom, and governing justly—the proposed selection process requires countries to score above the median in half of the criteria in any one category to be eligible. The problem with using medians as hurdles is that they change over time; if countries' policies improve, as we want them to, they will push up the hurdle and make it harder for others to be eligible. Where possible, setting absolute standards based on the first year's hurdles would be a better approach.

The current list of indicators includes only four criteria for “investing in people” but has six each in “good governance” and “economic freedom.” With fewer criteria in health and education, it is easier for countries to be eliminated on these. In fact, every country that misses eligibility by one indicator falls short in this category. Some of the indicators suffer from incomplete coverage, measurement problems or too much subjectivity that may prejudice poorer countries.

The board of the MCC has the right to apply judgment to the selection process. This may be useful in the cases of poor countries with sound policies but where there is insufficient data to measure progress. However, there is a risk that the MCC board will select countries for strategic reasons even if they do not meet the MCA criteria. There should be some flexibility in determining eligibility but with careful oversight by Congress.

Second tier: For the MCA to be regarded as a serious effort to address global poverty, it will have to offer some hope for those low-income countries whose institutions do not already meet the criteria. For instance, only five low-income countries in all of Africa are projected to qualify, and even if the next closest four also qualified, all nine together represent a mere 15 percent of the population of low-income countries in Africa. The Administration should consider assisting countries that just miss qualifying for the MCA or that have demonstrated good progress in a key development sector and meet governance standards. A second tier of MCA funds could be used towards building capacity and creating incentives for countries to graduate to the first tier.

MCA Design

Country Agreements: The Administration's proposal does not detail how its MCA contract relates to the proposal process. One possibility is for “implementation agreements” between recipient countries and the United States that would establish the funding parameters and guidelines under which proposals could be submitted by various governmental, private sector, and civil society or NGO actors.

Civil society participation/country ownership: Funding decisions should follow the principle of country ownership and should ensure that resources support priorities identified by the country's government in consultation with its citizens. Country agreements or contracts should be based on national development strategies or Poverty Reduction Strategy Papers and should form the basis for MCA funding decisions, with attention to redressing weak areas which require technical support and strengthening—including participatory processes. Broad-based civil society participation, including gender and ethnic diversity, should not be “assumed,” but rather proactively promoted and supported.

Multiple Mechanisms: Given the MCA's goal of innovation, there should be flexibility to utilize different approaches to delivering funds. Government to government contracts or grants may be useful in some situations, but not all. Civil society organizations have a role to play, and a vibrant civil society is necessary for good governance and to assure a people-focused approach to development. Direct funding to civil society should be an option under the MCA, as well as direct funding to regional and district level governments. International NGOs, which pair with local civil society for institutional strengthening and improved accountability, should also be eligible for funding.

Proposal Review: The MCA should include outside experts in the review of all proposals to strengthen the review process and increase the transparency of decision-making. The various stakeholders in the development process all have different perspectives that should be exploited to enrich outcomes. To ensure an open and fair process, the MCA could employ something similar to that of USAID's Office of Private and Voluntary Cooperation's approach to child survival funding. In this process, outside experts are hired as consultants to review and rank proposals for technical merit. The affiliations of these consultants are considered to avoid any conflicts of interest. Another approach would be a standing body of NGO and think tank experts who participate in the review. Any organization with a potential funding interest would recuse itself from the review of specific proposals.

Timeframe/Exit strategy: The Administration has suggested that it expects results in short, three-year timeframes. It is important that the Administration set negotiate reasonable expectations for what can be accomplished in such a time period. A careful balance must be struck between shorter timeframes for program support, and a longer-term commitment to poverty reduction. Exit strategies should be carefully planned in collaboration with recipient countries with a gradual tapering of assistance over one or more cycles of funding. This tapering off should be accompanied by efforts to identify new resources to replace lost Official Development Assistance funds to ensure sustainability.

Integrating Women into the MCA: Women's participation is essential to the success of all development strategies. Development literature shows consistently that education and economic empowerment enable women to follow-through on decisions that significantly improve the duration and quality of their own lives and the lives of their children. Women also contribute directly to their nations' economies, producing as much as 80 percent of all food and comprising 70 percent of the labor force employed in the manufacturing sector in certain regions. World Bank literature suggests that countries can significantly boost productivity and economic growth by focusing on the abilities and potential of women. To benefit from these synergies, gender measures should be considered in the design, implementation, and evaluation of the MCA.

MCA Implementation Structure

Board of Directors: The Board of Directors of the proposed Millennium Challenge Corporation (MCC) offers an opportunity for policy coherence that has previously not existed. Representation by key cabinet members whose portfolios have a bearing on economic development in developing countries can help ensure that U.S. economic and trade policies do not undermine the achievements of the MCA. Policy coherence would also benefit from better coordination among government agencies, USAID and the MCC. To maximize development policy coordination and coherence, the Board of Directors should include the Administrator of USAID. The Office of Management and Budget's role on the MCC Board, as proposed by the Administration, is less obvious. Consideration should also be given to having a larger Board of 5-7 members with representation from other government entities and from development experts in civil society and the private sector.

Advisory Council: The Administration's bill makes no concrete recommendations about the involvement of civil society in reviewing country proposals and serving in an advisory capacity to the staff and Board of the MCC. An advisory council made up of academics and representatives from NGOs, both from the U.S. and developing countries, could provide country-specific guidance and current thinking about the broader development issues.

Diverting Funds: The Administration's legislative proposal allows for funds to be diverted from other accounts to be used to carry out MCA activities. Given that the MCA will benefit a limited number of developing countries, it is essential that other foreign assistance accounts, that serve a much larger group of countries, issues and purposes, are not depleted to meet the needs of the MCA. The final authorizing legislation should limit the flexibility to divert funds.

Staffing: The Administration plans to limit the size of the MCC to no more than 100 staff. The staff will be made up of detailees from other U.S. government agencies and from outside the government for fixed term assignments. Such a model seems unrealistic to manage a development program of such magnitude. The MCC, as currently envisioned, should rely on the considerable experience of USAID, particularly the field missions and staff. USAID resources and authorities should be amended to accommodate these increased responsibilities so as not to disadvantage the core humanitarian and development programs administered by the agency. Furthermore, USAID should be reimbursed for the staff that is detailed to the MCC.

Policy Coherence

Donor Coordination: Significant time and resources are wasted by developing countries in complying with the wide range of donor requirements in applying for and reporting on funding. For example, Honduras receives support for its education programs from almost 50 separate funding sources, each with its own application process, missions to the country and reporting requirements. Basing MCA contracts on national development strategies or PRSPs provides one mechanism to ensure donor coordination since the international community has already agreed to these targets. The Administration's proposal acknowledges the importance of donor coordination. However, it places the burden solely on recipient countries rather than placing the responsibility with both the donors and developing countries.

Inter-Agency Coordination: In a similar vein there is no focus on increasing the coherence among the various United States' foreign assistance programs. In particular, there is a need to ensure coherence between development assistance and trade policy. For example, of the 36 countries that have been approved for AGOA (African Growth and Opportunity Act) only five are likely to qualify for MCA funding. Of the 24 countries in CBI (Caribbean Basin Initiative) only three are likely to qualify. There are different eligibility criteria and requirements for these various assistance mechanisms and some effort should be made to achieve coherence and complementarity amongst the MCA and other U.S. foreign assistance programs.

Oversight and Accountability

The MCA has been praised for emphasizing transparency, in using publicly available selection criteria, requiring public participation in the formulation of strategies and programs, and in planning to make available contracts and evaluations of activities under these contracts on the Internet. As noteworthy and constructive as these procedures are, Congress retains important oversight responsibilities, which should be specified in the legislation. Such procedures could stipulate that specific committees be consulted on a regular basis. Congress should consider whether an annual report or regular notifications best meet its need for information about the implementation of the MCA. These areas include:

Selection of eligibility criteria. While it is reasonable to give the MCC the flexibility to adjust eligibility criteria as new data and better measuring tools become available, Congress should be informed in advance and provided a rationale for changes in the criteria and/or their application.

Determination of eligible countries. Congress should be consulted/notified when the MCC uses its discretion, rather than strictly quantitative analysis, in the application of the eligibility criteria.

Use of notwithstanding authority. Congress should be notified of instances when MCA assistance is provided which would be prohibited under Part I of the Foreign Assistance Act, as is also the case with similar authorities in the Freedom Support Act.

Sector focus. Congress should be informed as to how funds are allocated in terms of sectors and types of assistance.

A second series of issues are raised by proposed accountability provisions to be included in the contracts between the MCC and eligible countries. Consideration needs to be given to how and by whom these benchmarks will be established and measured. The Administration's draft legislation recognizes the important role of civil society organizations in recipient countries in determining development priorities. Civil society organizations can also play a role in monitoring the implementation of the activities defined in the contracts. In addition, the role and responsibility of the MCC staff in evaluation of such activities must be planned carefully.

MCA and USAID

The best structure for the MCA would be a separate, semi-autonomous office within USAID with new authorities that enable faster, more flexible, and more innovative programming. Such an approach would allow for the MCA to help reform and revitalize USAID, enable USAID experience and expertise to guide the MCA, and create a framework for policy coherence and coordination amongst various foreign assistance programs. If the Congress agrees to establish a separate Millennium Challenge Corporation as the Administration has proposed, it will be important for efficiency and effectiveness to define the relationship between USAID and MCA.

Decision-making: USAID should be on the board of the MCC. This would enable USAID, with its strong institutional experience and knowledge in international development to inform Board decisions and policies, including selection of countries, development of country strategies, and review of funding proposals.

Implementation: MCC should utilize, and where necessary improve upon, existing mechanisms for implementing programs and disbursing funds. USAID should be the principle mechanism for implementing MCA programs and disbursing funds as it has the grant mechanisms and one of the best records of accountability with in the U.S. government.

Field Presence: The MCC should use the field infrastructure of USAID and of U.S. embassies where there is no USAID presence rather than trying to establish a new field presence in MCA countries. This will also help improve coordination between USAID-run programs and MCA programs.

U.S. Foreign Assistance Framework

In the consideration of the Millennium Challenge Account and various discussions of how best to organize and implement U.S. foreign assistance programs, it is useful

to step back and review the various purposes and uses of foreign assistance and where the USG expertise resides in implementing development assistance programs.

The U.S. Government provides various types of assistance to some 120 countries. They can be broken down into five broad categories:

Assistance to middle income countries which are still struggling to find a sustainable path of development: *USAID economic assistance, credit programs; OPIC; TDA*

Assistance to a limited number of low-income countries with reasonable governance and economic policies where increased amounts of assistance can help move them along the development process: *MCA candidates.*

Assistance to states that are failing, or immersed in or emerging from conflict: *USAID humanitarian and development assistance.*

Assistance to a larger universe of poor and low-income, low-performing countries that are struggling through the development process. It is in these countries where development assistance targeted to reform-oriented leaders, institutions, and communities can make a difference. Assistance targeted to building capacity in both government and civil society and delivering key services can lay the foundation for future reform. *USAID humanitarian and development assistance.*

Overlapping the above categories, a group of several dozen countries closely linked to U.S. foreign policy interests: U.S. assistance is important for country and regional stability: *USAID and State Department.*

MCA is but one component of U.S. foreign assistance. To maximize the impact of this new initiative, it must be part of a comprehensive U.S. development strategy and framework. The MCA initiative can be a critical new instrument of policy to fight poverty and promote growth and stability. Yet it does not address the development needs and objectives in the many nations that will not qualify. The initiative also does not take into account humanitarian concerns such as disaster response and refugees, or challenges that may require a global or regional strategy, such as HIV/AIDS. Therefore the MCA must be seen as a part of the overall aid strategy and funding of core bilateral development and humanitarian aid programs must also be increased to meet increased needs and challenges.

This paper reflects the views of a broad coalition of non-governmental organizations co-chaired by InterAction and Bread for the World.

MCA Coalition Members:

Academy for Educational Development
 AFL-CIO
 American Red Cross
 American Refugee Committee
 Audubon Society
 Basic Education Coalition
 Bread for the World (Co-Chair)
 CARE
 Catholic Relief Services
 CEDPA
 Center for Global Development
 Christian Children's Fund
 Council on Foreign Relations
 Episcopal Church
 Global Health Council
 InterAction (Co-Chair)
 International Center for Research on Women
 International Medical Corps
 International Orthodox Christian Charities
 International Rescue Committee
 National Council of Churches/Church World Service
 National Peace Corps Association
 Open Society Institute
 Oxfam America
 Population Action International
 RESULTS
 Save the Children
 Transparency International
 United Methodists
 U.S. Conference of Catholic Bishops
 U.S. Fund for UNICEF
 U.S. Global Leadership Campaign
 Washington Office on Latin America
 Women's Edge Coalition

World Learning
World Vision

Mr. BEREUTER. Thank you. I think your two requests are very reasonable for bipartisanship, and listening seriously and effectively to the input from the NGO community and others, the Committee would welcome an opportunity to meet both of your requests; at least, that is my hope.

Dr. Radelet, please summarize your statement for us.

**STATEMENT STEVEN RADELET, PH.D., SENIOR FELLOW,
CENTER FOR GLOBAL DEVELOPMENT**

Mr. RADELET. Thank you very much, and thank you for the opportunity to meet with you here today. I think the Millennium Challenge Account provides the opportunity to significantly improve the way that U.S. foreign assistance is delivered, and I think it is worthy of support. With some modifications, it could be even stronger.

Mr. Chairman, U.S. foreign assistance, in my opinion, stands at a crossroads. If the Millennium Challenge Account is implemented well, with strong program design, sufficient staffing, and if it is well coordinated with other programs, it could significantly improve the quality of United States foreign assistance, but if it is not done carefully, if it becomes politicized, or if it further fragments assistance policy into too many different agencies, the MCA could fail, which could weaken our foreign-assistance programs and set back our ability to meet important goals.

I think there are five key issues that require consideration. First, is the selection process. I have used the Administration's criteria. I have drawn the 16 indicators from the public sources that they have named. I have gone through their process rather carefully and come up with a list of countries that qualify in each of the first 3 years. That was attached to my testimony. According to these calculations, with data that are available today, 13 countries will qualify in the first year, and up to 19 could qualify in the first 3 years of the program.

Now, this list will change as new data become available. My list is not the Administration's list, and there are good reasons why they have not come public with theirs, but it gives an indication of the kinds of countries that might qualify for this.

The notion of selectivity builds on the idea that aid is most effective in governments that are committed to development, and I think this is a reasonable first attempt at identifying those kinds of countries, but it could be improved. As Mr. Beckmann indicated, I agree that we should focus this on the poorest countries. I would suggest eliminating the countries that the Administration includes in the third year, the lower, middle-income countries with incomes between \$1,435 and \$2,975. Those countries have less needs, more access to private capital, and they are slightly more political, since that group includes Russia, Egypt, Jordan, Colombia, and Turkey.

On a detailed issue, but it is an important one, the Administration wants to use median scores. There is a problem with median scores. We want other countries to become eligible for this. We want them to improve their scores. As other countries improve, the medians will rise, and countries that once qualified become dis-

qualified. I think we need to set standard scores, open scores that are absolute numbers. Those could change over time and be increased, but we need to have absolute scores rather than medians.

I think we need to reconsider the hard hurdle that the Administration has proposed on corruption. Corruption is a terrible thing. We are all against it, but the data are just not accurate enough to reject countries simply on that score.

Overall, I think we should not legislate these indicators. They are too imprecise. They need to be improved over time, but you should expect strong reporting from the Administration on a regular basis as to exactly what the indicators are and why they have used them, but I do not think they need to be legislated.

The second big issue is on the corporation. There are some advantages to a new corporation, but I think the biggest risk is that it could further fragment U.S. foreign-assistance policy. We have got too many agencies already, I think, and this could make it worse. If there is a new corporation, I think the Administrator of USAID definitely needs to be on the board to give a voice to development and to foster better communication and coordination with USAID in this program. I think the Administration's idea that 100 staff could be adequate for this corporation is way too small. I am absolutely in favor of an efficient and small staff, but I fear that, in being overzealous with 100 people, that you could actually make the program less effective than it could be, so I think it is going to need a little bit more adequate staffing.

But as an alternative, I think there are ways that this could be housed in USAID, separate from most of AID but still answering to the Administrator and try to move beyond some of the burdens that USAID labors under on earmarking, tied-aid procurement, and other kinds of things. So I think we do need to consider ways to bring this together within AID.

The third big issue is operations on the ground. The Administration envisions that qualifying countries would negotiate contracts as to the scope of activities that could be taken and that different organizations should implement those, but they are talking about a single contract signed with the government, and I think that there is a danger of inflating the size and the role of the recipient government. I think they need to open the process so that they could accept proposals from subnational governments, provincial governments, municipal governments, and also nongovernment organizations to make the proposal process more competitive and more open.

Also, in terms of operations on the ground, I think we need to really focus on monitoring and evaluation. That is going to be central to making this program results oriented and really work, but so far the Administration has not thought much about how they are going to do that better. This will require patience in thinking about operations on the ground. There is some talk about having a program here for a few years and then moving out after a few years down the road. Development takes time under the best of circumstances. One example: Ghana, which I think will qualify for the program; right now there per capita income is \$350. If they do everything right, absolutely everything right, and achieve 7 percent per capita growth, which would be among the highest in the world,

it will take them 21 years to reach the income level of \$1,435. So this cannot be, even under the best of circumstances, in and out.

My fourth point, very quickly—it has been raised here before—this is a great program for the countries that qualify, but there needs to be much greater thought, thinking more carefully about programs for the countries that do not qualify. We need to rethink our foreign-aid approach in these other countries, and this is going to require a new strategy for USAID. Mr. Natsios's comments are a step in that direction, but we need more.

Fifth, and finally, aid is important. Growth in these countries is more important. The policies in those countries are really important for establishing growth, but if we are really interested in helping the process, we have to rethink some of our other policies, particularly our trade policies, debt, intellectual property rights, and other things that create real burdens and take away opportunities for people in developing countries to improve their standard of living. Thank you very much.

[The prepared statement of Mr. Radelet follows:]

PREPARED STATEMENT OF STEVEN RADELET, PH.D., SENIOR FELLOW, CENTER FOR GLOBAL DEVELOPMENT

The Millennium Challenge Account (MCA) could bring about the most fundamental change to U.S. foreign assistance policy since President Kennedy introduced the Peace Corps and the U.S. Agency for International Development (USAID) in the early 1960s. The significance of the proposed program lies partly in its scale: the proposed \$5 billion annual budget represents a 50 percent increase over the \$10 billion annual foreign aid budget in FY '02 and a near doubling in the amount of aid that focuses strictly on development objectives.

Perhaps even more important than its size, however, is its potential to distinguish itself from existing aid programs. Through four guiding principles, the MCA could greatly improve the allocation and delivery of U.S. foreign assistance:

- It selects a relatively small number of recipient countries based on their demonstrated commitment to sound development policies;
- It provides them with sums of money large enough to make a real difference;
- It gives them more say in how the funds are used (relative to current programs); and
- It holds them much more accountable for achieving results, including being willing to increase funding for successful programs and reduce it for weaker programs.

Foreign assistance policy in the United States stands at an important crossroads. The MCA could be a turning point towards improving foreign aid, if it is well-implemented, supported by strong program design, has sufficient staffing (especially in recipient countries), is well-coordinated with other programs, and produces more effective results. In this case, it could be a model for other assistance programs and lead to stronger support from the public and Congress for initiatives supporting low-income countries. However, if diplomatic and strategic criteria come to dominate the selection process, the new corporation creates more policy fragmentation than coherence, or program evaluation is not taken seriously, the MCA could fail, which could weaken other programs and undermine the government's ability to achieve our national security goals.

Overall, the MCA initiative is worthy of support. It builds on America's core values of generosity, commitment to progress, and the expectation of clear results. Many of the ideas in the administration's proposal are appropriate and would make the U.S. foreign aid program more effective. With some adjustments, the initiative could be strengthened further. There are five key areas that require further consideration:

- the country selection process;
- the administrative structure within the USG;
- operations on the ground once countries are selected; and
- a strategy for the countries that will not qualify for the MCA.

- The consistency of other USG policies (especially trade policies) with the objectives of the MCA to support sustained economic growth and poverty reduction in poor countries.

I first comment on the strengths of the administration's proposal, and then on each of the five key areas for further consideration.

STRENGTHS OF THE PROPOSAL

There is much in the administration's proposal that should be commended and preserved.

- 1) *Focus on poverty and economic growth.* The MCA is clearly aimed at reducing poverty and stimulating economic growth in low-income countries, and not to reward diplomatic partners for strategic initiatives. The program's sharp focus will enable it to define specific goals, ensure that resources are better allocated to meet those goals, and allow for stronger and clearer evaluation of results. This should help ensure that both recipient countries and the American public get better outcomes from the program.
- 2) *Country Selectivity.* A central idea of the MCA is that aid can be more effective if it is focused on nations with governments that are committed to establishing policies and institutions conducive to economic growth and poverty reduction. Larger, more flexible programs like the MCA should be used in countries with a strong development record, while different strategies with more limited funding and more structured programs should be used in other countries.
- 3) *Recipient country participation.* The proposal implements a new approach in which government and non-government groups in qualifying countries take the lead in developing and defending their own ideas for using aid. This so-called "foundation" approach makes particular sense in well-run countries where there is the freedom and the capability to develop and manage programs. It has the advantage of allowing for real participation by civil society groups in recipient countries, both in the design of the overall MCA strategy and in implementation of funded projects and programs. The "selectivity" principle of the MCA goes hand-in-hand with improved recipient country participation.
- 4) *Transparency.* The proposed process is remarkably transparent, from the use of publicly available selection criterion, to wide public participation in formulating strategies and programs, to posting agreed "contracts" on the internet (although the legislation should ensure that all agreed contracts are thus posted). The administration is proposing a process through which it can be held publicly accountable for choosing appropriate countries and funding strong programs.

THE COUNTRY SELECTION PROCESS

Basic Methodology

The administration has proposed using 16 specific indicators to choose countries for the MCA (Table 1), grouped into the three broad categories proposed by the president: "ruling justly," "investing in people," and "establishing economic freedom." Countries must score above the median (measured against all broadly eligible countries) on half or more of the indicators in each of the three groups to qualify for the MCA. That is, they must surpass the median in three of the six "ruling justly" indicators, two of the four "investing in people" indicators, and three of the six "establishing economic freedom" indicators. In addition, a country must score above the median on corruption, regardless of how well it does on all the other indicators. This proposed methodology is basically sound, with some caveats as discussed below.

Using publicly available data and this methodology, I have produced an illustrative list of countries that might qualify for the MCA during its first three years.¹ It is crucial to emphasize that this list is illustrative: data on all 16 indicators will be updated before the program actually starts in October, so the group of top countries will change. In fact, the 16 indicators (from the World Bank Institute's governance data set) are due to be updated by the end of March 2003, so the list is likely to change within a few weeks.

¹For a detailed description see Steve Radelet, "Qualifying for the Millennium Challenge Account," http://www.cgdev.org/nv/Choosing_MCA_Countries.pdf

Moreover, the administration proposes to reserve the right to add or subtract a limited number of countries in determining the final set of qualifying countries. This last step introduces an element of subjectivity that probably is necessary given the weaknesses in the data, but must be used very selectively to guard against too much political influence in the selection process.

Possible Qualifying Countries

In the *first year*, the administration has proposed that the pool of countries eligible for consideration for the MCA should be those that have an average annual per capita income below \$1,435 and are eligible for concessional borrowing from the World Bank. There are 74 countries in this group. Table 2 shows that 13 of these countries might qualify for the MCA based on data currently available. Two other countries (Moldova and Nicaragua) failed to qualify because their corruption scores were below the median, although they met all the other requirements. Seven other countries miss qualifying by one indicator.

In the *second year*, the administration proposes expanding the pool of eligible countries slightly in line with an increase in program funding to include all countries with average per capita incomes below \$1,435, regardless of their borrowing status with the World Bank. This change increases the total number of eligible countries to 87. The new countries tend to be better off on average than the original 74, so the median values that a country must exceed to qualify rise on most of the indicators.

As a result, only 11 countries qualify in the second year, including 8 that had qualified the first year. The three new countries are China, the Philippines and Vietnam, although China will not receive MCA funds.

In the *third year*, the administration proposes sharply expanding the pool of eligible countries in year three (in line with the increase in annual funding to the full targeted amount of \$5 billion) to include 28 nations with average per capita incomes between \$1,435 and \$2,975. This group of countries would be judged separately from the 84 countries with average incomes below \$1,435, with their own median scores used to assess country qualification. Adding this last group of nations is controversial. The administration's main reason for including them is that many people in these countries still live in poverty. However, as conveyed by Table 3, this group of nations is far better off than the 87 countries eligible in year two, with average incomes more than four times higher, much lower infant mortality rates, and much higher literacy rates. They also have much greater access to alternative sources of financing, with higher private capital flows, saving rates, and government revenues.

Thus, including this new group of countries would divert aid resources away from countries with greater needs and fewer financing alternatives. In addition, adding this group heightens the possibility that MCA funds will be diverted to support political allies as it includes Colombia, Russia, Egypt, Jordan, and Turkey, among others. In my opinion, these 28 countries should not be eligible for MCA funds. Alternatively, if they remain eligible, the administration should allocate only a limited portion (a maximum of \$1 billion) of the annual \$5 billion for them, with the rest reserved for the poorest nations.

Based on data available today, 4 of these 28 nations—Bulgaria, Egypt, Namibia, and South Africa—would qualify in year three if the administration's proposal were adopted, as shown in Table 2. Note that these countries are in addition to those that qualify in year two (not instead of), since they compete to qualify as a separate group.

Thus, based on the administration's proposal, over the course of the first three years 19 different countries (excluding China) might qualify for the MCA. Eighteen others miss qualifying by one indicator (including corruption). Conceivably several of these countries could improve their scores and attain qualification within a few years, thus increasing the number of MCA countries. Of the 19 countries most likely to qualify, 8 are in sub-Saharan Africa (SSA), 5 are in South and East Asia, 3 are in Eastern Europe and Central Asia, 2 are in Latin America, and 1 is in North Africa.

Strengthening the Selection Process

In my opinion, *the selection process should not be legislated*—the administration will need some flexibility to adapt the system during its early years—but *Congress should expect regular and thorough reporting on the selection process*. The administration's proposed methodology to select MCA countries is a reasonable initial approach, by and large. However, the process could be improved with some relatively modest changes:

- As discussed, eliminate the countries with incomes between \$1,435 and \$2,975 from eligibility to focus the MCA on countries with the greatest needs and least alternative financing options.
- Change the qualification standard from median scores to fixed levels (e.g., a 75% immunization rate) for the indicators where this is possible. Median scores will change from year-to-year, creating a moving target for countries hoping to qualify. Moreover, as additional countries strive to qualify and improve their scores, medians will rise, moving some of the initial countries out of the qualification pool.
- Modify the requirement that countries must score above the median on corruption to qualify for the MCA. Although corruption is extremely important, the data are not reliable enough to be used to eliminate countries.
- Strengthen some of the indicators, especially the trade deficit, the budget and expenditure data, and days to start a business.
- Consider adding a limited number of additional measurable indicators, including the ratio of girls-to-boys in school, an additional health indicator, and a measure of state ownership of productive assets in manufacturing and retail trade (but not in utilities and basic service delivery).

Finally, although the indicators give a strong weight to democracy (through 3 of the 16 indicators), there is no firm requirement for a country to be a democracy to qualify for the MCA. A small number of non-democracies appear on the list of possible qualifiers shown in Table 2. The question is whether the MCA should be aimed at all low-income countries that are committed to use aid effectively to fight poverty and stimulate growth, or limited to democracies with that commitment. A rule requiring countries to pass a democracy hurdle (while leaving other selection criteria the same) would reduce the number of qualifying countries during the first three years from 19 to 14.

ADMINISTRATIVE STRUCTURE

A New Corporation?

The U.S. foreign aid system, particularly USAID, is bogged down under heavy bureaucracy, overly restrictive legislative burdens, and conflicting objectives. The MCA is intended to be different. The administration has proposed that the program be administered through a new “government corporation” designed to reduce administrative costs and increase effectiveness.

The biggest advantage of establishing a new organization is that it could avoid the political pressures, bureaucratic procedures, and multiple congressional mandates that weaken current aid programs. Its status as an independent body could make it more flexible and responsive as well as allow it to attract some top-notch talent. Since the MCA is supposed to do business differently than other aid programs, with a narrower focus, higher standards, and more flexibility, it follows that there is a strong case for situating the MCA in a new institution.

However, establishing a new corporation risks further fragmenting foreign assistance programs across the Executive Branch. Major foreign assistance programs currently reside at USAID, the State Department, Treasury, and the Peace Corps, with other programs at HHS, the Department of Agriculture, the African Development Foundation, the Inter-America Foundation, and several other agencies. Adding yet another agency could impede coordination and increase redundancy.

An alternative structure would be to house the MCA in a new office or bureau at USAID. It would report to the Administrator, but would otherwise be separate from the existing USAID bureaucracy. It would require separate authorizing legislation to ensure greater efficiency and reduced administrative burdens. Staff could be a combination of USAID personnel and staff detailed from other agencies. This structure would put the major development programs under a single presidential appointee and ensure greater coordination of programs.

If the plan to establish the corporation goes forward, several steps should be taken to ensure it works as effectively as possible:

- The Board should include the administrator of USAID rather than the Director of OMB. In addition, it should include a small number of outside experts representing private business, NGOs, or others with development expertise. Alternatively, an outside advisory panel could support the Board’s operations.
- Staffing needs to be adequate for the task, especially on the ground. The administration hopes to keep the corporation small, but its projected staffing of 100–200 people seems insufficient for a program with an annual budget of \$5 billion. It would be unfortunate if the zeal to make the new corporation as

lean as possible resulted in poor evaluation, oversight, and coordination. Furthermore, It is not clear who will represent the MCC on the ground in the qualifying countries, where a strong presence will be required to achieve success.

- Much stronger coordination mechanisms will be necessary, both amongst USG agencies and with multinational organizations. One of the biggest concerns is the impact of the new corporation on USAID and the relationship between the two organizations. The corporation is likely to draw staff and resources from USAID, furthering weakening the agency, possibly engendering some resentment, and making cooperation more difficult. Having both agencies operate simultaneously in recipient countries could be very confusing for recipient countries, create coordination problems and unnecessarily duplicate services. To date, these coordination issues apparently have received very little attention.

OPERATIONS ON THE GROUND ONCE COUNTRIES QUALIFY

Contracts

The proposal to enter into “contracts” with recipients is basically sound, as it puts program design and implementation responsibilities squarely with the recipient country while building in clear accountability for achieving agreed benchmarks. However, the administration’s proposal seems to envisage that a recipient government would coordinate a variety of proposals from government and non-government groups, and, through a local consultative process, consolidate them into a single contract with the MCC. This could inadvertently enlarge the power and bureaucracy of the recipient government. *A better approach would have the MCC accept proposals from a variety of organizations within eligible countries, including sub-national governments and non-government groups.* This would create a larger administrative burden for the new corporation, but it would lead to better quality and more effective programs on the ground.

Monitoring and Evaluation

To be successful, the MCA will require a very strong monitoring and evaluation (M&E) system. Strong M&E will be central to allocating funds appropriately, learning what works and what doesn’t, avoiding absorptive capacity problems, and otherwise making the program more effective. Each “contract” should include clear plans for the recipient to establish internal M&E operations. In addition, an independent outside M&E function will be crucial, perhaps through the GAO. Without a much stronger monitoring and evaluation (M&E) capacity than in past programs, the MCA will be doomed to fail.

The results of these evaluations must be taken seriously if the MCA is to succeed. Strong M&E programs will help redirect activities that have gone off course, provide the basis for increasing funding for successful activities, and reducing funding for weak programs. *The USG must be willing to reduce or eliminate MCA funding for programs that are not achieving results.* Recipient countries will quickly recognize whether program benchmarks are taken seriously or not. Where programs are succeeding, they should be funded generously; where they are off-track, funding should be reduced; and when they fail, funding should be directed elsewhere. Being true to this principle will certainly distinguish MCA from existing aid programs.

Program Duration

Although the focus on results is critical, at the same time it is important to keep expectations in line with reality. Development takes time. Recent analysis of the experience of 22 relatively successful developing countries (such as Korea, Thailand, Chile and Botswana) shows that for those countries it took on average 12 years before their aid levels were reduced by 50 percent, and 24 years before their aid levels fell by 75 percent.² Many MCA recipients will continue to be low-income countries with limited access to private sector financing for many years, even if all goes very well. Consider Ghana, a prime candidate for the MCA, with current per capita income of \$350. If it does everything absolutely right and achieves per capita growth of 7% per year (equivalent to about 9% overall growth, a rate achieved by only Korea, Botswana, and a few other countries), it will take Ghana 21 years to reach per capita income of \$1,435.

² See Michael Clemens and Steven Radelet, 2003, “The Millennium Challenge Account: How much is too much, how long is long enough?” www.cgdev.org/nv/features—MCA.html.

Earmarks and Tied Aid

The Congress can play an important role in shaping this legislation and helping pave the way for the program to be both more responsive to needs on the ground and more cost-effective in achieving results. The promise of the MCA to be different—to make a measurable difference in the lives of the poor—requires that both the Administration and Congress act differently than they have in the past. Congress, of course, has both the right and the responsibility to direct where appropriated dollars should be spent. However, too much detail in this directive process is counterproductive.

Congress should resist the temptation to earmark, even to target what may seem like important activities and countries. The accumulation of such earmarks, even when they seemed sensible and enlightened, gradually undermined USAID's ability to respond flexibly and efficiently to the changing needs of recipient countries. Congress should also resist the temptation to "tie" MCA assistance to U.S. goods and services, as has been the case with the vast majority of past U.S. bilateral assistance. Tied aid reduces the effectiveness of foreign assistance, by some estimates reducing the ultimate value to the recipient by 25%.

WORKING IN COUNTRIES THAT DO NOT QUALIFY

The MCA promises to be a terrific program for the countries that qualify, providing them with generous funding and more flexibility in setting program priorities. However, it will reach a relatively small number of countries, and so by itself is not a complete foreign assistance strategy. Other strategies are needed to reach the many countries that will not qualify.

Of particular importance are the countries that just miss qualifying for the MCA, the so-called "tier II" countries. If the MCA is to fulfill its promise for a growing number of countries over time, strong programs will be necessary in countries that aspire to qualify. USAID should work closely with these countries to develop strategies to help them eventually gain eligibility for the MCA. For example, traditional aid programs could be changed to allow them to write limited proposals focused on the specific areas where they fall short of qualification. It may make sense to use some MCA funding for this purpose. But the second tier countries should not be part of the MCA until they meet the eligibility requirements.

Other developing countries further from qualifying for the MCA will require more limited and clearly focused strategies, perhaps working through NGO organizations where appropriate. In countries with less committed and capable governments, we must provide greater oversight and less flexibility to recipients. Other strategies are necessary for weak and failed states that have little hope of qualifying for the MCA, but are none-the-less critical for U.S. security interests. These are the toughest cases. In many situations, the most the USG can do is provide humanitarian assistance, and in some countries we should provide no assistance at all.

The important point is that USAID needs to develop a clear strategy for its programs in countries that do not qualify for the MCA. USAID staff members are currently in the early stages of developing such a strategy, and this process should be supported and nurtured. Congress can help by rethinking some of the strictures that encumber USAID's operations, especially the amount of funds earmarked for specific purposes and tied to American suppliers. Moreover, non-MCA programs will require strong funding. *It is crucial that MCA funding not come at the expense of these other programs.* These steps and others would help improve the efficacy of the overall foreign assistance program.

POLICY COHERENCE

Improving foreign aid will not be enough to achieve the goals of spreading greater openness and prosperity around the globe. While most of the burden lies with developing country governments to implement sound policies, the U.S. must re-think some of its non-aid policies that affect these nations. The most important are trade policies. U.S. textile quotas, high tariffs on agricultural products, and farm subsidies undermine competition and deny workers in poor countries the opportunity to make better lives for themselves. The African Growth and Opportunity Act was a good start, but it was too limited in leveling the playing field for poor countries. If the USG is serious about helping the poor countries, we must reduce the impediments that we have created that undermine the opportunities for growth in low-income countries.

Table 1. Eligibility Criteria for the MCA

Note: To qualify, countries must be above the median on half of the indicators in each of the three sub-groups.

Indicator	Source
I. RULING JUSTLY	
1. Control of Corruption	World Bank Institute
2. Rule of Law	World Bank Institute
3. Voice and Accountability	World Bank Institute
4. Government Effectiveness	World Bank Institute
5. Civil Liberties	Freedom House
6. Political Rights	Freedom House
II. INVESTING IN PEOPLE	
7. Immunization Rate: DPT and Measles	WHO/World Bank
8. Primary Education Completion Rate	World Bank
9. Public Primary Education Spending/GDP	World Bank
10. Public Expenditure on Health/GDP	World Bank
III. ECONOMIC FREEDOM	
11. Country Credit Rating	Institutional Investor
12. Inflation	IMF
13. Regulatory Quality	World Bank Institute
14. Budget Deficit/GDP	IMF/World Bank
15. Trade Policy	Heritage Foundation
16. Days to Start a Business	World Bank

Source: "Fact Sheet: Millennium Challenge Account," distributed by the administration on November 25, 2002, available at www.cgdev.org.

Table 2. Possible Qualifying Countries Using the Administration's Criteria

	Year 1: IDA Eligible Countries With Per Capita Incomes Less Than \$1,435	Year 2: All Countries With Per Capita Incomes Less Than \$1,435	Year 3: Countries With Per Capita Incomes Between \$1,435 and \$2,975
QUALIFYING COUNTRIES			
1.	Albania	Bangladesh	Bulgaria
2.	Bangladesh	Bolivia	Egypt
3.	Bolivia	China	Namibia
4.	The Gambia	Honduras	South Africa
5.	Ghana	Lesotho*	
6.	Georgia	Malawi	
7.	Honduras	Mongolia	
8.	Lesotho*	Philippines	
9.	Malawi	Senegal	
10.	Mongolia	Sri Lanka	
11.	Mozambique	Vietnam	
12.	Senegal		
13.	Sri Lanka		
ELIMINATED BY CORRUPTION			
1.	Moldova	Ecuador	
2.	Nicaragua	Moldova	
3.	Nicaragua		
4.	Ukraine		
MISSED BY ONE INDICATOR			
1.	Cambodia	Albania	Jamaica
2.	Guyana	Cambodia	Jordan
3.	India	The Gambia	Tunisia
4.	Mali	Georgia	
5.	Nepal	Ghana	
6.	Uganda	Guyana	
7.	Vietnam	India	
8.		Kazakhstan	
9.		Kyrgyz Rep.	
10.		Mali	
11.		Morocco	
12.		Mozambique	
13.		Uganda	

*For Lesotho, data for the corruption indicator are currently unavailable, so technically it would not qualify. However, these data are expected to become available within the next few months, and Lesotho is likely to qualify when the MCA begins in late 2003.

Source: Steven Radelet, updated from "Qualifying for the Millennium Challenge Account," www.cgdev.org

Table 3. Development Status, Resources Flows and Financing for Three MCA Country Groups (medians)

	IDA eligible countries with income less than \$1435	Countries with income less than \$1435	Countries with income between \$1435-\$2975
Development Status			
GNI per capita, 2001	\$380	\$460	\$1965
Adult illiteracy rate, adult total, 2000 (%)	36	33	14
Life expectancy at birth, 2000 (years)	54	56	70
Mortality rate, infant, 2000 (per 1,000 live births)	75	69	27
Resources Flows and Financing			
Aid/GNI, 2000 (%)	10.8	8.5	1.4
Gross private capital flows/GDP (%)	6.9	8.7	10.3
Tax revenue/GDP (%)	11.7	12.6	21.8
Gross domestic savings/GDP, 2000 (%)	7.3	8.4	16.2
Number of Countries	74	87	28

Source: Steven Radelet, "Qualifying for the Millennium Challenge Account," www.cgdev.org

Mr. BEREUTER. Dr. Radelet, thank you very much for your very specific suggestions and critique.

Dr. MacCormack, we are pleased to hear a summary of your written statement.

STATEMENT CHARLES F. MacCORMACK, PH.D., PRESIDENT AND CEO, SAVE THE CHILDREN

Mr. MACCORMACK. Thank you, Mr. Chairman. Speaking on behalf of over 160 U.S. nongovernmental organizations, members of Interaction, first of all, we strongly endorse the general directions of the Millennium Challenge Account. You would know it is very difficult to get all of us to agree on very many things, so to see this kind of unanimity speaks very positively about the general directions. We think the concepts represent some of the best thinking of the past decades and lessons learned about development, that focused, significant support can move countries from poverty into self-sustaining growth.

Thirty years ago, Save the Children was working in Korea, Taiwan, Malaysia, Thailand, Tunisia, Mexico, and the Dominican Republic. We are not working in any of those countries today, and many of them are financing their own development, so we know it is possible for countries to graduate.

At the same time, we also feel that U.S. development assistance is at a crossroads. How this plays out will determine the amount of support the American public will feel for development assistance and how effective it is, and there are three or four critical issues that I would highlight, some of which Steve Radelet has already mentioned.

First of all, the relationship between USAID and the Millennium Challenge Corporation is crucial. The legislation is very general about how that is going to work. We feel there needs to be one leader, one voice, one field delivery system. At Save the Children, we cannot have two people speaking in regard to what our strategy and policy and priorities are. We cannot have two delivery systems, one of which is lean and modern and the other one of which is seen as the place where all of the rest have to go. These two systems have to be brought more closely together.

Somehow, somewhere, there needs to be a single, strategic plan developed that describes what our entire strategy is for this whole range of poor countries in the world. The Administrator of USAID should sit on the board of the Millennium Challenge group. The implementation systems should be merged between USAID and the Millennium Challenge Account, and AID's strength on the ground should be incorporated into this delivery system. Ideally, the strengths of the two systems should be combined so that the accountability and the leanness and the focus of the Millennium Challenge Account and the knowledge of local conditions of AID should be brought together in delivering one coherent, development-assistance program.

Secondly, we feel that the Millennium Challenge Account should focus on the poorest countries, and that focus should remain. The middle countries do have access to many other forms of assistance and support: Private-sector taxation, domestic resources. They are already four times wealthier per capita than these poor countries. These are very precious resources that can save lives. We feel they should be directed to the poorest countries.

Thirdly, we feel it is very important that there is a mechanism to strengthen civil society, both within the countries and globally. Some of the greatest breakthroughs in development history have involved civil society. Polio eradication was driven by Rotary, an organization that is represented in practically every congressional district in this country. Microenterprise was driven by the Gramene Bank. Saving Newborn Lives is driven by Save the Children and the Bill and Melinda Gates Foundation. It is the combination of citizen initiative and government support that brings about real development.

And, finally, if the funding of the Millennium Challenge Account de facto results in reducing core development accounts, then we will help save lives in one set of countries at the expense of lives in other countries. The fiscal year 2004 proposed budget of the Administration reduces the Child Survival Account, for example, by 15 percent. In our opinion, it would be a tragedy if we rob Peter to pay Paul, and funds for life-saving accounts in other areas are essentially utilized to fund the Millennium Challenge Account. Thank you.

[The prepared statement of Mr. MacCormack follows:]

PREPARED STATEMENT OF CHARLES F. MACCORMACK, PH.D., PRESIDENT AND CEO,
SAVE THE CHILDREN

Thank you Mr. Chairman and Representative Lantos, for the opportunity to testify before this committee on the Millennium Challenge Account (MCA). I know that I speak for my colleagues in the non-governmental organization (NGO) community, when I say how much we appreciate your leadership, commitment and cooperation to ensuring that the Millennium Challenge Account enhances the U.S. foreign assistance program.

Save the Children was founded in 1932 as a nonprofit child-assistance organization to make lasting, positive change in the lives of children in need. Today we work in 18 states across the United States as well as in more than 40 countries in the developing world to help children and families improve their health, education and economic opportunities. We also mobilize rapid life-support assistance for children and families caught in conflicts and other humanitarian emergencies. We have been working with a coalition of organizations on developing a policy consensus around the Millennium Challenge Account. Today I am going to try to represent broadly some of the views and concerns from the NGO community around the MCA.

When the President announced the MCA initiative at the Monterey Conference nearly a year ago, we in the NGO community were among those cheering the loudest. Not only because the President announced a 50 percent increase in resources going towards development, though that would be reason enough. To us the most important part of the announcement was that the President recognized combating poverty to be—and I quote—“a moral imperative and one of the top priorities of U.S. international policy.”

We believe President Bush’s strong and consistent statements reflect a growing consensus in this country that development assistance can bring lasting and positive change in the lives of the world’s poorest people. The MCA provides the opportunity to revitalize and redefine the foreign assistance strategy of the United States and to maximize the impact, effectiveness and coherence of our aid programs. The debate and discussion around the creation of the Millennium Challenge Corporation will have a critical effect on how development is carried out in the years to come by the United States and other donor nations.

Why does Save the Children support the MCA? We know from our own experience that sustainable economic and social growth is the best form of development. Three decades ago, we were working in Korea, Thailand, Malaysia, Lebanon, Tunisia, the Dominican Republic and Mexico. These countries have now all “graduated” from our direct support, and are able to fund their basic programs for children and families from their own resources. We have seen lasting and positive change.

My remarks will attempt to define a framework for development that would help expand the moral imperative the President talks about and increase our nation’s ability to help many more children and their families around the world break the cycle of poverty, and build a brighter, more prosperous and stable future.

Let me make four key points:

First, we believe that the MCA, although representing a significant step forward, should be seen as one piece of the larger U.S. foreign assistance strategy puzzle. We believe that a new corporation to administer MCA should work collaboratively with the U.S. Agency for International Development. USAID is essential to the success of the MCA initiative. We need one strong foreign aid program where the best of both the MCA and USAID are combined. We believe that the accountability measures, the focus on results and the absence of earmarking in the MCA should be a key part of the work of USAID. Likewise we want to see the knowledge, skills, and hands-on development assistance experience of USAID brought to bear in the delivery of MCA assistance. We should be using the MCA to improve the impact of our overall development program and not to replace it.

Similarly, we must seek coherence in the implementation of our foreign assistance programs. For example, while it is clear that the U.S. Department of Health and Human Services (HHS) has an important role to play in key technical areas related to HIV/AIDS, we believe that USAID can and should continue to play a leadership and coordinating role in delivering such assistance. USAID has the technical staff, field-based presence, and technical and operational partners already in place, and working on prevention, care, and treatment efforts in developing countries. We become concerned when we hear about domestic agencies hiring staff and gearing up in such areas as child labor, civil society strengthening and basic education in the developing world when those same resources could be used much more effectively to expand the reach of existing USAID programs. We call on Congress to support these important programs, but to do so in a way that creates a cohesive development strategy. We believe that this is best done when programs are coordinated by one development agency.

Nonetheless, the President has decided he wants to create a separate agency to administer the MCA—the Millennium Challenge Corporation (MCC). As Congress moves to consider this proposal, I would make the following recommendations:

USAID should be on the Board of the MCC and an active participant in MCC decision-making.

USAID, as the most experienced and knowledgeable U.S. government development agency, must be positioned to inform Board decisions and policies, including selection of countries, development of country strategies, review of funding proposals and assessment of performance.

The MCC should utilize existing mechanisms for implementing programs and disbursing funds.

The MCC should use the field infrastructure of USAID and of U.S. embassies rather than trying to establish a new field presence in MCA countries. This will also help improve coordination between USAID run programs and MCA programs.

The MCA is not meant to replace the development assistance programs being provided by USAID. The MCA must be in addition to, and not a substitute for, other core bilateral development and humanitarian programs. The MCA can help serve

as a catalyst for a comprehensive and coherent new aid policy that recognizes progress and encourages change.

Second, the Millennium Challenge Account must provide focused assistance to the poorest of the poor. It is very important that we remember that the MCA as the President has defined it is a bonus pool or incentive pool of large concentrated assistance that we will provide to a small, select group of countries that meet the eligibility criteria set forth in the President's proposal.

So how should an MCA for high performing countries be structured? I won't focus on the criteria. Steve Radelet is the resident expert on that. But one thing I want to emphasize is that the MCA should target the best performers *among the poorest countries*. We would target MCA assistance on the IDA countries—those that have a per capita income below \$1,435 and are eligible to borrow from the World Bank. The Administration seeks to expand the MCA to lower middle-income countries.

Many of these lower middle-income countries do indeed have a lot of poor people. But most of these lower middle-income countries also have many more means of attracting capital and alternative sources of financing through larger flows of private capital, greater tax revenue and higher domestic savings rates. Additionally, as Steve Radelet has often noted, the lower-middle income group of countries is more than four times richer than the combined low-income group of countries and has substantially lower illiteracy rates, higher life expectancy and lower infant mortality.

If there is a concern that not enough poor countries will meet the eligibility criteria, then we would advise that the pool be expanded by providing a lesser amount of MCA funds to the "near miss" countries to help them qualify in future years. The legislation that we've worked on with the NGO consortium, InterAction, calls for a second tier of MCA countries that would fall into this category. Thus a part of the MCA funds could be directed towards building capacity and creating incentives for countries to graduate to the first tier. If we agree with the Administration that the MCA is about reducing poverty and encouraging growth—and we do—then we must use these resources where they can make the greatest impact on poverty.

Third, the Millennium Challenge Account should not undermine the important role that NGOs and civil society can play in building safer, healthier, more effective civil societies around the world. Government-to-government aid alone is not going to solve our toughest problems. NGOs are often best equipped to deliver assistance at the grassroots level. NGOs have the experience and expertise to help design and implement programs that work. They also can play an important role in making sure that governments practice what they preach—that they deliver on their promises.

The truth is, some of our most successful efforts involve innovative programs launched by concerned non-profits that have mobilized tremendous resources from a wide range of corporate, government, multi-lateral and non-profit partners. Consider the fight to eradicate polio—this was an initiative spearheaded by Rotary International that cut across many governments and agencies and involved many NGOs as well.

The results have been remarkable. More than 550 million children have been immunized against polio, and the number of countries still plagued by this disease has plummeted from 125 to 9. This program has already prevented over five million cases of paralysis worldwide—an astounding achievement. This success story would not have happened without the essential partnership between governments and NGOs. It was Rotary International that joined with the U.S. government, UNICEF, and key NGOs such as Save the Children to ensure that the campaign to eliminate polio is a success.

Congress should make sure that the new MCA initiative encourages and nurtures such partnerships.

And this brings me to my final point, these development successes can only be realized if we encourage the Congress to make good on the President's pledge that the funding for the MCA not come at the expense of other development assistance initiatives. For example, a review of the proposed FY04 budget indicates a nearly 15 percent cut in basic child survival and maternal health programs—both are exemplary USAID-supported development programs that have delivered cost effective, life-saving services to millions of children and mothers around the world. But more remains to be done. Nearly 11 million children under age five continue to die each year because they lack access to the proven, basic, low-cost services delivered through these programs.

We call on the Administration and Congress to recognize the great success stories in development assistance—child survival, birth spacing, basic education and micro-enterprise, to name a few—by continuing to *increase and support these programs*.

We continue to believe that the MCA can play a transforming role in U.S. development policy. The President has laid out a bold new vision for expanding the circle of development. You in the Congress will play a critical role in shaping this initiative and we look forward to working with you.

Mr. BEREUTER. Thank you, Dr. MacCormack. Mr. Schaefer, I will be pleased to hear a summary of your remarks.

**STATEMENT BRETT D. SCHAEFER, JAY KINGHAM FELLOW,
CENTER FOR INTERNATIONAL TRADE AND ECONOMICS, THE
HERITAGE FOUNDATION**

Mr. SCHAEFER. Thank you. I think I speak on behalf of the diverse staff at my department at Heritage, the Center for International Trade and Economics, which includes a Vietnamese woman, and Argentine woman, and a Korean man, that we are happy to be so popular here today. Before I begin, I would like to address some of the comments made earlier today.

The Heritage Foundation will not be used to decide civil liberties, as was indicated earlier. It will be used, if Congress approves, for the trade-policy indicator. The basis for this is the Index of Economic Freedom, which is widely praised as an accurate and objective publication in analyzing economic policies around the world.

Just recently, this past January, the President of the African Development Bank made this comment.

“Too often . . .”

and I quote,

“Too often, the whole region is associated with civil unrest and political instability, and while some regions and countries have, indeed, been subject to such upheavals, it is obviously not an accurate image of the entire continent. It is unfortunate that such negative images of the continent persist despite the considerable reforms and improvements registered in a significant number of countries and recognized by such monitoring bodies as the Economist Intelligence Unit, the Wall Street Journal, and the Heritage Foundation.”

So I think that some other people do recognize the worth of the work that we do.

That being said, I will go into my statement and try and make it a little bit shorter than I otherwise would.

Mr. Chairman and Members of the Committee, it is an honor to be here today to discuss the Millennium Challenge Account. I believe that the MCA is a vital issue that could have important ramifications for the United States but, more importantly, for poor people around the world. The United States has spent hundreds of billions in taxpayer dollars on development assistance to help poor countries increase growth and prosperity. The record of this effort has been disappointing, with few recipients experiencing substantial improvements in per capita income. The evidence provided by numerous studies indicates that this failure is not due to insufficient funds but to poor policies in recipient countries.

Taking lessons from this experience, the Bush Administration has unveiled the Millennium Challenge Account, a new, development-assistance program for countries ruling justly, investing in their people, and encouraging economic freedom. The MCA will be

different from previous aid programs because recipients would earn eligibility by surpassing minimum criteria based on simple, transparent, and publicly available performance indicators. These indicators have been selected based on evidence that they contribute to, or are complementary to, long-term growth and prosperity rather than on subjective political motivations unrelated to development.

I applaud the Administration's focus on policies. Good policies are the key to economic growth and development. The policies themselves lead to increased economic growth. They attract foreign investment, which contributes to economic growth, and development assistance has been shown to be effective only in conjunction with good policies.

In the interest of time, rather than repeat the description of the MCA, which has already been covered very well here today and with which I largely agree, I will go straight into my thoughts about how the proposed MCA could be improved.

The basic framework of the MCA is sound, involving a relatively small number of recipients, a focus on poor nations, recipient country participation in the programs and projects, clear objectives for assessing progress, holding recipient countries accountable for their policies, and a focus on policies contributing to economic growth and prosperity without which there can be no development. But there are several issues that I think would improve the overall administration of the MCA and prevent recurrence of past failures.

First, Congress should make it difficult, but not impossible, to change the MCA indicators once they are determined. Making substantial improvement in indicators may require significant reform that will not bear immediate fruit. Potential recipients must be reasonably certain that the criteria will not change midstream after they undertake reform. Moreover, frequent manipulation of the criteria could arouse suspicions that eligibility is subject to political manipulation rather than based on an objective analysis of performance. Therefore, once established, the indicators should be difficult to change.

The 16 indicators that are proposed by the Administration have the strength of being widely available for eligible countries. They are easy to measure, updated relatively frequently, are transparent, publicly available, and are largely objective. However, new and better indicators may be formulated in time. To ensure the best use of indicators while preserving the fairness and transparency of the MCA, performance indicators should be changed only when justified by empirical evidence and with the support of Congress.

Second, Congress should ensure that eligibility for the MCA is determined solely according to a country's performance. Using indicators to establish eligibility encourages prospective recipients to improve. For this incentive to be effective, countries must be able to determine what improvements must be made to qualify for the MCA. For this reason, the effectiveness of the MCA would be undermined if the Millennium Challenge Account Corporation or its board of directors is permitted to approve MCA assistance to countries that do not qualify based on their performance.

As more political subjectivity is inserted into MCA eligibility, there is less incentive for countries to improve. Therefore, the sole

criterion of MCA eligibility should be a country's performance on the established indicators. The MCC or the board should be empowered only to rule out potential recipients—for instance, when a military coup occurs unexpectedly or when a nondemocratic country qualifies, as mentioned earlier—but it should not be able to approve countries that do not meet the established criteria.

Third, Congress should use eligibility to maintain constant pressure on MCA countries to improve. What I mean by this is that eligibility for the MCA should not be static. Instead, it should require improvements by recalculating the median value annually to take improvement into account and incrementally raise the bar for eligibility. However, countries must be able to tell what is necessary to qualify in the upcoming year in order to undertake appropriate measures for improvement.

To make eligibility predictable for potential recipients, the median should be calculated using the indicator values from 2 years prior to that used to determine whether a country is qualified or not. The bar should be based on the previous year's data so that a country can use that known data to set its current policies in order to be eligible for the MCA.

Fourth, Congress should require annual, independent assessments of the MCA's success in meeting its goals. Assessment of the effectiveness of the MCA-funded programs and projects should be conducted by an independent auditor to maximize objectivity. The reports should evaluate the success rates of MCA-funded projects and determine the contribution that the MCA has made to increased growth and development in recipient countries.

Finally, Congress should create a sunset provision that terminates authority for the MCA if it does not prove to be more effective than existing development-assistance programs. The strongest argument for the MCA is that it is an alternative approach to existing development assistance which has proven largely ineffective at increasing economic growth and prosperity. There is no need for two development-assistance programs that are equally ineffective. Therefore, authorization for the MCA should sunset after a period sufficient to measure its effectiveness in accomplishing its stated goals.

In my opinion, the Millennium Challenge Account represents a fundamental shift in development assistance because it would provide assistance only to countries with an established record of adopting policies that have proven complementary and conducive to economic growth. I urge Congress to give the MCA an honest opportunity to operate with the freedom and independence necessary to determine if it can be more successful in spurring growth and prosperity than America's development assistance in the past. For that reason, I think we should have a competitive synergy between the MCA and USAID. Some sort of firewall has to be established.

Mr. Chairman, this concludes my testimony, and I will be pleased to answer any questions that the Committee may have. Thank you.

[The prepared statement of Mr. Schaefer follows:]

PREPARED STATEMENT OF BRETT D. SCHAEFER, JAY KINGHAM FELLOW, CENTER FOR INTERNATIONAL TRADE AND ECONOMICS, THE HERITAGE FOUNDATION

Chairman Hyde, members of the committee: It is an honor to be here today to discuss the Millennium Challenge Account. With permission, I would like my full statement submitted for the record.

The President's proposed MCA is a vital issue that could have important ramifications in the United States, but more importantly for poor people around the world. The United States has spent hundreds of billions of taxpayer dollars on development assistance to help poor countries attain growth and prosperity. The record of this effort has been disappointing, with few recipients achieving substantial improvements in per capita income. The evidence provided by numerous studies indicates that this failure is due not to insufficient funds, but to the poor policies of recipient countries.

Taking lessons from this experience, the Bush Administration has unveiled the Millennium Challenge Account (MCA), a new development assistance program for countries "ruling justly, investing in their people, and encouraging economic freedom."¹

The MCA would be different from previous aid programs because recipients would earn eligibility by surpassing minimum criteria based on simple, transparent, and publicly available performance indicators. These indicators have been selected based on evidence that they contribute or are complimentary to long-term growth and prosperity rather than on subjective, political motivations unrelated to development.

The Administration has identified 16 performance indicators to measure progress in these three areas. To qualify for the MCA, a country must score above the median² for half of the indicators in each policy area—that is, it must pass three of the six performance indicators that measure good governance, two of the four that measure investment in people, and three of the six that measure economic freedom. The Bush Administration also has determined that countries *must* pass the "control of corruption" indicator to qualify.

In terms of income requirements, only countries with a per capita income less than \$1,435 will be considered during the first two years of the MCA.³ In the third year, countries with a per capita income between \$1,435 and \$2,975 will also be considered. The median scores for each income group will be computed separately.

Focusing MCA resources on countries with good policies is appropriate; based on World Bank and academic analysis, which has found that development assistance programs spur growth only in countries with sound policies and institutions, it is clear that aid is far less effective in bad policy environments and can actually be counterproductive.⁴ Other World Bank studies have demonstrated that open markets and economic liberalization provide the fastest, most reliable path to growth and prosperity.

A 2002 study, *Globalization, Growth, and Poverty: Building an Inclusive World Economy*, found that "globalized" developing countries (nations where trade as a percentage of GDP is high) achieved an annual average growth rate of 5 percent in per capita income during the 1990s. In less globalized developing countries, the "aggregate growth rate was actually negative in the 1990s."⁵ Contrary to claims raised by anti-globalization activists, World Bank analysis also found that globalization helps the poor as much as the rich and improves labor and environmental standards in the long run.⁶

¹Remarks by the President on Global Development, "President Proposes \$5 Billion Plan to Help Developing Nations," White House, Office of the Press Secretary, March 14, 2002, at www.whitehouse.gov/news/releases/2002/03/20020314-7.html.

²The median for each indicator is calculated from the indicator values for all countries in the same per capita income bracket. There are two brackets: less than \$1,435 and between \$1,435 and \$2,975.

³For the first year, eligible countries must have a per capita income below \$1,435 and be eligible for International Development Association assistance. For the second year, all countries with a per capita income under \$1,435 would be eligible.

⁴David Dollar and Lant Pritchett, *Assessing Aid: What Works, What Doesn't, and Why*, World Bank Policy Research Report (New York: Oxford University Press, 1998), pp. 14–23, at www.worldbank.org/research/aid/pdfs/overview.pdf.

⁵Paul Collier and David Dollar, eds., *Globalization, Growth, and Poverty: Building an Inclusive World Economy*, World Bank Policy Research Report (New York: Oxford University Press, 2002), p. 5.

⁶David Dollar and Aart Kraay, "Trade, Growth, and Poverty," World Bank, Development Research Group, World Bank, Abstract, June 2001, at econ.worldbank.org/files/2207-ups2615.pdf; and Paul Collier and David Dollar, *Globalization, Growth, and Poverty: Building an Inclusive World Economy*, World Bank Policy Research Report (New York: Oxford University Press, 2002). See also David Dollar and Aart Kraay, "Growth Is Good for the Poor," World Bank,

The Index of Economic Freedom, published annually by The Heritage Foundation and *The Wall Street Journal*, confirms these studies.⁷ As the *Index* shows, 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 that promote economic freedom provide an environment that facilitates trade and encourages entrepreneurial activity, which in turn generates economic growth.

HOW TO IMPROVE THE MCA

Mr. Chairman, the basic framework for the Millennium Challenge Account is sound, but Congress can improve its administration and prevent the recurrence of past failures in development assistance. Specifically, I believe that Congress should:

1. *Make it difficult, but not impossible, to change MCA indicators once they are determined.*

Making substantial improvement in the indicators may require significant reform that will not bear immediate fruit. Therefore, potential recipients must be reasonably certain that the criteria will not change in midstream after they undertake such reform. Moreover, frequent manipulation of the criteria could arouse suspicions that eligibility is subject to political manipulation rather than based on objective analysis of performance. Therefore, once established, the MCA indicators should be difficult to change.

The 16 performance indicators proposed by the Administration have the strength of being widely available for eligible countries, easy to measure, updated relatively frequently, transparent, publicly available, and largely objective. However, new and better indicators may be formulated in time. To ensure use of the best indicators available while preserving the fairness and transparency of the MCA, performance indicators should be changed only when justified by empirical evidence and with the approval of Congress.

2. *Ensure that eligibility for the MCA is determined solely according to a country's performance in the 16 indicators identified by the Administration.*

Using the indicators to establish eligibility encourages prospective recipients to increase their efforts to improve in the 16 indicators identified by the Administration as contributing to development. For this incentive to be effective, countries must be able to determine what improvements must be made to qualify for MCA assistance.

The effectiveness of the MCA will only be undermined if the Millennium Challenge Corporation (MCC) or its Board of Directors is permitted to approve MCA assistance to countries that do not qualify for that assistance based on their performance. As more political subjectivity is inserted into MCA eligibility, there is less incentive for countries to improve. Similarly, Congress should resist the temptation either to earmark specific amounts for specific countries or regions or to attach requirements in addition to the 16 indicators identified by the Administration for MCA eligibility, as these will dilute the MCA's objectivity and effectiveness.

Therefore, the sole criterion for MCA eligibility should be a country's performance in the established indicators. The MCC or the Board should be empowered only to rule out potential recipients, for instance when a military coup occurs in an MCA qualifying country, not approve countries that do not meet the established criteria.

Politically motivated assistance, to the extent it is deemed necessary, and humanitarian assistance should be made through other assistance programs: Child Survival and Health Programs Fund, Development Assistance, Economic Support Fund, Foreign Military Financing, International Military Education and Training, and others.

4. *Use eligibility to maintain constant pressure on MCA countries to improve.*

Eligibility for the MCA should not be static. Instead, it should require improvements by recalculating the median value annually to take improvement into account and incrementally raise the bar for eligibility. However, countries must be able to tell what is necessary to qualify in the upcoming year in order to undertake appropriate measures to improve.

Development Research Group, World Bank, April 2001, at econ.worldbank.org/files/1696-ups2587.pdf; and Richard Roll and John Talbot, "The End of Class Warfare: An Examination of Income Disparity," April 20, 2002, at www.anderson.ucla.edu/acad-unit/finance/wp/2002/5-02.pdf.

⁷Gerald P. O'Driscoll, Jr., Edwin J. Feulner, and Mary Anastasia O'Grady, *The 2003 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2003).

The Administration's suggested eligibility criteria—exceeding the median in half the factors in each of the three categories of indicators (3 indicators in ruling justly, including corruption, 2 indicators in investing in people, and 3 indicators in economic freedom)—will likely use the most recent data available to determine eligibility. To make eligibility predictable for potential recipients, the median should be calculated using indicator values from two years prior to the year for which eligibility is being determined.

For instance, if 2003 data are used to compute the median of all potential MCA recipients in 2004, Country X has no way to change policy by the time the data become available at year end. However, if eligibility for 2004 is based on 2002 data, Country X will know that the median is, for example, 5 percent of GDP and can pass a health budget for 2003 to surpass the median for that indicator. This gives potential recipients the ability to adopt policy changes to meet criteria while putting pressure on countries to improve their policies in reaction to rising medians.

5. Require annual independent assessments of the MCA's success in meeting its goals.

The reports should evaluate the success rates of MCA-funded projects and determine the contribution that the MCA has made to increased growth and development in recipient countries.

6. Create a sunset provision that terminates authority for the MCA if it does not prove more effective than past development efforts.

The strongest argument for the MCA is that it is an alternative approach to existing development assistance, which has proven largely ineffective at increasing economic growth and prosperity. There is no need for two development assistance programs that are equally ineffective. Therefore, authorization for the MCA should sunset after a period sufficient to measure its effectiveness in accomplishing its stated goals: strengthening the rule of law and reducing corruption; increasing economic freedom, growth, and prosperity; and improving health and education in recipient countries.

Reauthorization should be permitted only by a majority vote of the House and Senate finding that the MCA has been more successful than traditional development assistance. The basis for this evaluation should be a 10-year review by Congress, based on annual reports, that provides:

1. The specific objectives of the MCA program, both for each recipient country and for individual projects funded fully or partially by the MCA, and an independent assessment of the extent to which those objectives were achieved;
2. Data on the status of all MCA recipient countries according to the 16 eligibility criteria when first evaluated by the MCC, the improvement in those criteria made over the first 10 years of the MCA, and an estimate of how much of that improvement can be directly attributed to MCA efforts and projects; and
3. Data on the status of all MCA-eligible countries according to the 16 eligibility criteria when first evaluated by the MCC, the improvement in those criteria made over the first 10 years of the MCA, and an estimate of how much of that improvement can be directly attributed to efforts to achieve and maintain MCA eligibility.

If the MCA proves more successful than traditional development assistance, it should be promoted as a model for development assistance in the multilateral development banks and for other major bilateral donors. Moreover, traditional development assistance should be directed into the MCA to improve the effectiveness of America's development efforts. Obviously, security and humanitarian assistance have other purposes and should remain outside of the MCA.

CONCLUSION

The Millennium Challenge Account represents a fundamental shift in development assistance because it would provide assistance only to countries with a proven record of adopting policies that have proven complementary and conducive to economic growth.

I urge Congress to give the MCA an honest opportunity to operate with the freedom and independence necessary to determine if it can be more successful in spurring growth and prosperity than America's development assistance in the past.

Mr. Chairman, this concludes my testimony. I would be pleased to answer any questions the committee may have.

—*Brett D. Schaefer is Jay Kingham Fellow in International Regulatory Affairs in the Center for International Trade and Economics at The Heritage Foundation.*

Mr. BEREUTER. Thank you, Mr. Schaefer. Thanks to all of you for your written testimony as well as the summaries we just received. I will begin the question period. I notice a high degree of consensus among you, which is encouraging. I think both Dr. Radelet and Dr. MacCormack expressed some concerns about the fact that in the third and fourth year of the Administration's proposal, although this is not specified in the proposal that came to us, it suggested that they would move to lower middle-income countries.

Some of those countries, such as South Africa and the Philippines, have a very significant pocket of very low-income people, and the largest single concentration in the world of poor people is in northeast India and Bangladesh. Bangladesh would nevertheless qualify in year 1 or 2. What is your reaction to the fact that you would thereby not focus resources on those major pockets of poverty? Is it that you believe these countries are not spending the resources that they have sufficiently to pull these people up to a higher median income? What is your suggestion or comment related to this concern? Dr. Radelet and Dr. MacCormack or anyone else as well.

Mr. RADELET. It is a very good question, and I think that we do need to recognize that poverty exists in some of the lower middle-income countries. Some of those that you mentioned—India, Bangladesh—would meet the lower level of income and be eligible in the first group.

Mr. BEREUTER. Not India, apparently, not until year 3.

Mr. RADELET. India does not make the qualification. They are in the group of eligible countries to compete in the lower. They do not actually make enough of the 16 indicators to qualify, but they would be in the first group of countries that could compete. Their per capita income is still below \$400 per capita, so they are definitely in the program in terms of eligibility to compete.

The Philippines and several other countries in the lower middle-income group, in my opinion. Even though their poverty is quite significant, they have access to private capital, they have much higher savings rates, they have much greater domestic investment, and they have resources available to them that they can use for poverty programs. We should continue foreign-aid programs with them, but I think at just a more limited level than within the MCA.

South Africa, I think, is a fairly unique situation. They have a higher per capita income because it is such a split, a dual economy, and there is a significant portion of people there that are quite wealthy and others that are quite poor. So I think South Africa is the one case of where I have second thoughts about eliminating that higher group. But, again, I think that there are other programs that can be made available to those.

The issues you raise, I think, need to be weighed against the fact, as I mentioned, that they do have other resources available and private sector capital. But also I fear that by including this group that the system could be a little bit more politicized because countries like Egypt, Jordan, Colombia, Russia, and Turkey would be in that group of possibly qualifying countries. They would be eli-

gible to compete, and I worry that it could politicize the system more than we would like. So my solution would be to focus really on the poorest countries and then think about individual countries like South Africa using existing programs.

Mr. BEREUTER. I understand your points. Dr. MacCormack, do you have anything to add to that?

Mr. MACCORMACK. I would agree with all of those points, and I would just add that, to me, this is all the more reason why there needs to be one overview of what is happening in terms of support for this range of countries. In general, it ought to be the case that the right trade policies will bring in outside investment, the right tax policies will mobilize domestic resources, the right internal investment programs will bring local savings in the Philippines and countries like that. If those things are not happening, someone should be able to identify that, and at that time we might then look at whether Millennium Challenge Account funding is necessary.

Mr. BEREUTER. I would like to come back, while I still have some time remaining, to perhaps the most basic questions. I will split it into two. Why not have USAID implement the MCA? Why create a new agency? Would the creation of a new development agency undermine the mission and support for USAID? Are you worried that it will be marginalized? I think this is perhaps the most basic question that occurs to Members. I would welcome comments from any of you and will then go to Mr. Bell, and I think we will have a chance for a second round. Dr. Beckmann?

Mr. BECKMANN. We would favor setting up the Millennium Challenge Account as some sort of special office within AID for the reasons that Dr. MacCormack laid out. The counterargument is that AID has been hamstrung by a multiplicity of directions and specific instructions from high levels in the Administration and from Congress. In terms of selecting countries, if Andrew Natsios wants to move money from a low performer to a higher performer in development policy, the State Department will not let him do that.

The argument for the MCC is that, first, it would be clearly development conditionality rather than foreign-policy conditionality, and it would be a fresh start, so you would not have this host, this legacy, of earmarks and special directives for this and that. But the best way to solve this problem is to create the MCA within USAID and also give it a mandate to use development conditionalities, not to be beholden to the foreign-policy interests, and to give it special freedom so that it can do what it needs to do.

It makes sense to put it in USAID, and if it is going to be separate, there need to be serious structures of collaboration. It is a real mistake that the legislative proposal from the Administration does not even mention USAID. That is just crazy.

Mr. BEREUTER. Let us not put them on the board.

Mr. BECKMANN. Right.

Mr. RADELET. I would just add to that, I think there are some advantages to the independent corporation, and it could be made to work, so I would not be completely opposed to that idea; but I think it could also be made to work and perhaps even better within USAID if we can remove some of the burdens, as Reverend Beckmann mentioned, that impinge upon AID's performance.

Lots of people today have mentioned about the past performance not being very good. That is because we give a lot of our aid to political allies for different objectives, good objectives, national security objectives, but they are different objectives than improving health and education. We do not select the countries by those criteria where it is overburdened by earmarking, tied aid, heavy procurement rules, those kinds of things.

So if we can put it within AID, apply the selectivity criteria, make it focused on poverty reduction and economic growth, and remove some of the burdens that have been harmful to USAID, it would have the advantage of being much more coordinated and having one presidential appointee that is responsible for development assistance instead of two.

Mr. MACCORMACK. If I can just reiterate, I think it could be very dangerous and divisive to have two foreign-aid organizations and delivery systems. It is quite likely that they will be compared and contrasted. If one is seen as successful and lean and involving the best and the brightest and the other is dealing with all of the rest, that could really further reduce support for USAID.

Mr. Lantos once used the analogy of the Saturn program at General Motors, but Saturn was always a part of General Motors, and the best practices of Saturn were, in fact, backed into General Motors. It does seem to me, to the fullest extent possible down the line, the best practices of the Millennium Challenge Corporation ought to be backed into USAID, if at all possible.

Mr. BEREUTER. Mr. Schaefer, would you like to comment?

Mr. SCHAEFER. I agree that the ability of AID to meet its stated goals of increasing development are largely hindered by some of the earmarks that Congress has laid on it, but I do not share the faith that we are going to have success in removing those earmarks. In fact, I think that it is more likely that we are going to see more earmarks, not less, in the future.

That is why I see the advantage of an independent MCA. We can finally have a government agency solely devoted toward development efforts. That is the only criteria, the only rule, the only purpose for the organization, and that is the only situation wherein you are going to find out if development assistance really can be truly as effective in increasing growth and prosperity that we hope it can be. If you put it back into USAID, I think you are going to have a temptation to apply the same restrictions that apply to AID development assistance right now to the MCA in the future. This would inhibit the effectiveness of the MCA experiment, which has very real ramifications for poor people around the world, to be given a chance to work. Thank you.

Mr. BEREUTER. The gentleman from Texas, Mr. Bell, who has made a meteoric rise from the front row to the Ranking Member of the Committee. Welcome.

Mr. BELL. From a bookend to Ranking Member in no time at all.

Thanks to all of you for your testimony here today. I really appreciate it, and I have a couple of questions. I want to start with Dr. Radelet, if I could, on the selection criteria and the indicators, and let us start with what you mentioned about corruption because I do think there is reason for concern there.

Obviously, as you pointed out, we are all against corruption and would like to see it eradicated in the countries that we are helping, and I think everybody understands that. But I am assuming and would like for you to touch on in a little more detail how you think this might impact the selection process and what we could be looking at because, based on what I have heard, it could be the number-one eliminating factor, possibly.

Mr. RADELET. All of the indicators, any indicators, are measured with errors, and there is a difference between what we actually observe in real life and what the indicators show. Any statistics can do that, and the Administration recognizes that. That is one of the reasons that countries only have to pass half of the indicators because if you miss it on one, if your score is incorrectly too low on one, it might be incorrectly too high on the other. They, to a large extent, take into account the imperfections in the data, but they are hard and fast on the corruption indicator, and it is imperfect.

Corruption is a subjective indicator. There is nothing you can go out and measure like an immunization rate about corruption. It is people's subjective opinions about whether corruption is getting better or worse, and so naturally there are margins of error.

Now, there are a couple of ways that you could correct that. You could eliminate only countries that are in the bottom 25 percent. For example, the ones that are really at the bottom of the list are completely identified. Others are in the next 25 percent, while they do not get credit for that hurdle, but it does not completely eliminate them from the program. That is one possibility. Another would be that if countries have low corruption scores, we would ask them to provide more evidence to show if they do not believe that those corruption scores are accurate. So I think that there are some ways that it could be improved.

Now, there are several countries that are eliminated by corruption. It is not a huge number, but if you took that measure out, in the first year, instead of 13 countries qualifying, you would have 15 that would qualify. In the first 3 years, instead of 19 countries qualifying, you would have something like 22 or 23, maybe 24. So it does eliminate some countries, but if you just took that out as a hard hurdle and kept the medians and the fact that they would have to pass half the indicators, you would get a few more, but not dozens more.

Mr. BELL. What are some alternative indicators that you or anyone else on the panel might like to see included in the selection criteria?

Mr. RADELET. I would like to see a few more on health and education. There are only four there. Resource-poor countries have a tough time getting high immunization rates and high school completion rates, even though they are making great effort. A country might go from a 25 percent immunization rate to a 40 percent immunization rate and not get any credit for it because it still does not pass the median.

So one thing would be to look at changes. Another would be to complement school completion rates with school enrollment rates because we can see progress in those more quickly. Another possibility would be to look at the ratio of boys to girls in education, which is both an education indicator but also a gender indicator in

terms of if there are biases in more educational opportunities for boys than girls.

On private sector opportunities, there is nothing in here about state control of productive assets, and there is great controversy over privatization, but some parts of privatization are less controversial. Retail stores, manufacturing outlets; those should be privatized. Financial institutions and banks should be held in private hands. So we should have an indicator of state control of those kinds of productive assets. Probably not worry so much yet about state control over utilities and other service deliveries or privatization of electricity and water. Those kinds of things are so much more controversial.

So I think there are some ways like that that the list of indicators could be improved.

Mr. BELL. Dr. MacCormack, did you want to comment?

Mr. MACCORMACK. I would just highlight the basic education for girls as an indicator of gender equity and also an indicator of many other important health and enterprise developments.

Mr. BELL. Mr. Schaefer.

Mr. SCHAEFER. Of course, you can consider a number of different indicators, and I am sure the Administration would be eager to share with you its analysis of various indicators that it considered but did not include in the final analysis. But one thing that I would caution is against putting too many indicators in there. Once you start increasing the number, it becomes a little bit unwieldy and difficult to get into the overall process.

Mr. BELL. Reverend Beckmann, did you have anything on that?
[Nodded no.]

Mr. BELL. Mr. Schaefer, I want to discuss with you for just a moment the sunset component that you are recommending and how you see that working. You said a period sufficient to measure the effectiveness. How long a period do you think that would be, and how would you see that working?

Mr. SCHAEFER. Well, I envision it being based on the annual reports of assessments of the MCA progress in achieving the objectives set forth in the country compacts and set forth by the corporation itself. You have to give a certain amount of time to really see the overall impact of it, and so something on the order of 10 years would be, I think, a reasonable time to gauge whether you are seeing significant progress, and what you are hoping to get, which is increased economic growth and prosperity, investment in the people, and the ruling justly factors.

Mr. BELL. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Mr. Bell. I think we will have time for another round, if you want to participate. I know I do.

With respect to, coming back to the board, it has been mentioned here that USAID is not a member. Of course, through the State Department, you could suggest they are. One thing that occurs to me is that USDA is not suggested for membership on it, and supposedly they should have some expertise and should understand the expertise of the land-grant institutions.

The Secretary of State is the Chairman, or his designee is the Chairman, of the MCC. Another related question: Are you concerned that this could lead to overpoliticization of the assistance or

jockeying within the State Department for the Chairman to influence the board? Does anyone want to venture comments on this subject? Reverend Beckmann.

Mr. BECKMANN. One of the exciting things that has been going on is that the President's proposal for the MCA set up high-level discussion, ongoing discussion, and fairly intensive discussion among the senior agencies of the Administration. So we have had Treasury, State, and OMB and the National Security Council actually talking about how to reduce poverty in the world and talking together. That is pretty rare. My sense is that on a day-to-day basis, within this Administration or the Clinton Administration, USAID is pretty far down in the pecking order.

Now we have had a Secretary of the Treasury going to Africa and Secretary Powell talking about poverty reduction. For them and their under secretaries to be talking together routinely with the National Security Council and OMB about world poverty has been an important step forward.

Even if the MCA is closely connected with AID, we will still have a scattering of development efforts among other departments with all of the multilaterals connected to Treasury, for example. If we were trying to fight terrorism with the kind of divided structure that we use to fight world poverty, we would never win.

So one advantage of this proposed board structure is that it would institutionalize ongoing conversation between the Secretary of State, the Secretary of Treasury, and a White House institution. There is some advantage in that. But I think it is a serious oversight that AID would not be in the board. When the conversation started after the President's MCA speeches, AID was not in the working group. They had to work like the dickens even to get invited to the meetings. That is symptomatic, and if we are going to set up a new agency with a new board, AID needs to be part of it.

I guess I would argue that having State and Treasury and AID talk together about development would be a real step forward. You might also bring in USDA or HHS—my understanding is that in Kenya the HHS, through the Centers for Disease Control, has a bigger program than AID. You could bring in these other departments that have international development programs. But the disadvantage of that is that the board would be bigger, and the secretaries themselves would be less likely to attend.

Mr. BEREUTER. Anyone else have comments on these questions? Dr. Radelet.

Mr. RADELET. Yes. If I could add to that, on your specific suggestion about USDA, I think they could certainly bring some things to the board, and it is a worthy idea. The issue is, as Reverend Beckmann mentioned, there are other agencies as well: Health and Human Services; the Environmental Protection Agency; even the Department of Defense has some development projects; the Department of Energy; Education. So you could have a proliferation, and I worry a little bit if the board were structured that way, that there might be some arguments and some in-fighting and some pressures to funnel money to one or more programs and that kind of thing rather than a more coherent development approach.

Mr. BEREUTER. Thank you. Any comments on USAID?

Mr. RADELET. Yes. I think that USAID should be part of the board, that we want the communication there. You had mentioned worries about State politicizing this. They could do that. This is better than having the program run by the State Department. That is for sure. You have the other members of the board that could help reduce the politicization. You also might consider having non-government appointees to the board, as we do with OPIC and Ex-Im Bank, to also bring in outside opinions but reduce the amount of politicization.

Mr. BEREUTER. That is a good idea, I think, as a matter of fact. Dr. MacCormack.

Mr. MACCORMACK. I would just endorse those two points. I think it is crucial that the Administrator of USAID be on this board. The Secretary of State, the Secretary of the Treasury, the head of OMB have day jobs that require them to be thinking about many other things, in addition to development assistance. There needs to be someone on that board from the time they get up in the morning until the time they go to bed are thinking about these issues and are bringing that to the table.

I do think the possibility of outside directors is well proven in entities like this and would deal with the politicization question that you raised.

Mr. BEREUTER. Mr. Schaefer, do you have any comments on this set of questions?

Mr. SCHAEFER. No. I do not have any feelings as far as USAID is concerned. I think they would provide some insight, and I am certain that AID professionals who have experience in the countries that eventually are eligible under the MCA will be seconded over to the MCA. So I am certain that you are going to have expertise in the interaction with AID, and I do not see any reason why Administrator Natsios could not contribute to that process.

Mr. BEREUTER. As I conclude my questions, I will just make the observation, which I am sure is apparent to you but may not be to everybody listening, much of the controversy or concern about the 16 criteria are for things that are not in the legislation. The discussion presentation about what it is, section to section, is fleshed out with the possibility or the proposals as to how it will be implemented. That is one of several areas where, in fact, the detail is not in the statute presented to us in the Administration's legislative proposal. Mr. Bell.

Mr. BELL. Thank you, Mr. Chairman. I only have really one remaining question having to do with the fiscal year 2004 budget request, and I will start with Dr. MacCormack because you seemed to raise some concern about it. The Administration has pledged that the MCA would not be funded at the expense of other development or humanitarian assistance, and I am just curious if you believe that the President's fiscal year 2004 budget request fulfills that promise.

Mr. MACCORMACK. Overall, there has not been an aggregate reduction in the total foreign-aid budget, but these particular health accounts have been reduced, so we obviously feel those remain very important.

Mr. BELL. Reverend Beckmann.

Mr. BECKMANN. When we looked at the 2004 budget, we tried to make judgments about what is in there that is development assistance that is relevant to poor people, poverty-focused development assistance. It looks to us like OMB skimmed on all three of the President's new initiatives—the MCA, AIDS and hunger. They did a little less on each than the President promised when he gave his speeches. But in the aggregate, poverty-focused development assistance in the fiscal year 2004 budget goes up \$1.8 billion. That shows real earnestness on the part of the Administration that they are serious about putting new money into reducing poverty, hunger, and disease around the world. I think it should be more, but a \$1.8 billion increase is pretty impressive relative to what a lot of domestic programs got.

Mr. BELL. Mr. Schaefer or Dr. Radelet?

Mr. RADELET. Just one, quickly. My understanding from the budget numbers is that the proposed increases do not come at the expense of existing programs if you measure them against the 2002 actuals and the Administration's 2003 request, but for the 2003, if the omnibus bill goes through as proposed, there are certain things, in particular, child survival, that look like they will go up in the 2003 budget, and if the Administration's request in 2004 goes through, they would then come back down. So it depends a little bit on your base. They do come down off the 2003 budget as it has now gone through the omnibus process.

Mr. BELL. Thank you, Mr. Chairman.

Mr. BEREUTER. Mr. Payne, we were about the adjourn, but we are going to recognize you under the 5-minute rule for this panel.

Mr. PAYNE. Thank you very much. Let me apologize for being away. I will certainly read the testimony. Actually, I had lunch with the President of Rwanda, President Kogami, who was talking about their constitution that they are completing and that they are even going to try to move toward elections.

If we took Rwanda, for example, with this new MCA organization, as you know, Rwanda was a country where 6-, 700,000 people were killed. We did not do any preemptive strike. We did not send in teams to inspect. We did not make ultimatums. We did not tell the people perpetrating the genocide that we want to inspect their weapons. We allowed 700,000, close to a million people, to be killed as the world just watched. As you know, if it were not for General Kogami and the Rwanda Patriotic Front coming in and actually saving the remaining Tutsis who were going to be exterminated, there probably would be no Tutsis left. They were having what they called the "final solution" with the Hutu extremists.

Now, they have not had an election since. The majority of people are Hutus. The minorities that are left are the Tutsis. They have had a lot of reconciliation. People have come back, shared homes, and people who perpetrated the genocide are sharing the same house with those who lost people through genocide.

I say all that to say, then, that if this new corporation, this MCA, with this bureaucratic group, and the Heritage Foundation and Freedom House do an evaluation, they would automatically exclude Rwanda. They have not had elections, so, therefore, they cannot be justly—what is that? What is the term they are using?

Mr. RADELET. Ruling justly.

Mr. PAYNE. Yes, ruling justly. That really sounds very empirical, from a high place looking down to see if we are ruling justly. Sometimes we need to evaluate some of our programs right here, such as for the homeless in New York, to see if we are ruling justly, but that is another issue.

How do we then have a country like Haiti that struggles year in and year out—where people take boats to try to reach our shores. Most of them drown. You never hear about them. Sharks eat them. They will never come close to qualifying under this new fund. Church groups have constantly fed them, as you may know, but there will be nothing available to them because they do not meet the criteria.

How do you see this Millennium fund really helping the poorest of the poor or those who need it? Do you think it is going to then serve as an incentive to make the bad rulers good and, therefore, their countries qualify? Maybe each of you might just tell me what you think.

Mr. BECKMANN. Bread for the World is really enthusiastic about the Millennium Challenge Account proposal. It is not the answer to everything, but what's exciting about it is that it is proposed as an addition to what we are already doing. Mr. Natsios this morning talked about how AID is already starting to rethink their program in ways that should, in fact, allow for them to do more in some of the countries that would not qualify for this MCA assistance.

Before President Bush was elected, I would not have expected him to be the advocate for a major increase in development assistance; but President Bush here, a very conservative U.S. President, is proposing an additional \$5 billion a year in development assistance that is focused on poverty reduction. There is nothing in this legislation about these countries having to help us with terrorism. The MCA really is focused on poverty reduction.

Now, if I had an extra \$5 billion a year, I think I could come up with a better way to reduce poverty than this, but that is not the case. We have a chance now, because this is coming from President Bush, to, in fact, get a major increase in funding from the U.S. Government on a bipartisan basis focused on reducing poverty and hunger in Africa and around the world. There are some ways I would make the Administration's proposal better, but I think the MCA, as an addition to the other things that we need to do, really deserves your support.

Mr. RADELET. I think your example of Rwanda is a good one. I have been working closely with them over the last couple of months and with my friend, Donald Kabaruka, the finance minister, who is an outstanding civil servant working under extraordinarily difficult circumstances. But I do not think the MCA is the right program for them, for the reason that there is a lot of evidence that foreign assistance works best in countries that have a modicum of good policies in place and good institutions so that aid can be used effectively. Part of the MCA is to give more responsibility to the recipient countries, give them a lot more money but a lot more flexibility in how they use those funds: Use them more broadly, use them for a lot of things, allow them to show us how they are being more accountable, with some outside accountability

as well. But there needs to be some measure of strong institutions to be able to do that, and some poor countries can achieve that, but Rwanda is not there yet, and I think before we give them that much flexibility and that much responsibility, we need to help them get up to the grade so that we can give them that responsibility.

That calls for the need for rethinking our other approaches and not thinking of just the MCA. We need the MCA to work in countries that qualify for it. For other countries that will not qualify just yet, like Rwanda, let us think about very focused strategies within USAID that can work with Rwanda and other countries like that. Identify the weaknesses, and have good, strong, flexible programs without the bureaucracy that exists now to try to move them up to the point where we think we can provide them with larger foreign assistance and much more flexibly, and allow them to do the accountability.

Mr. MACCORMACK. I could not agree more that it is crucial to maintain the funding for proven, existing programs like child survival, basic education for girls, HIV/AIDS prevention and support, and working with orphans, Micro Enterprise for Women, and in Rwanda and Haiti these programs should be continued and sustained and ideally expanded. Where possible, their delivery should be improved. The lessons of MCA do not have to be just left with MCA. So where USAID systems can be leaned down and focused, that should happen with these other programs.

But then I finally would say that, in general, these additional funds should be for those countries that have really pulled all of the different factors together that will allow them to build toward sustainable, self-sustaining development.

Mr. SCHAEFER. I would just like to second everything that has been said thus far and note that Administrator Natsios has identified these types of countries as the primary focus for what he sees as USAID's role in a post-MCA environment: These countries' near misses, these failing states, and the countries in between that do not quite qualify for the MCA, and the MCA obviously would not apply, at least immediately, to Rwanda.

I would like to clarify one issue. The Heritage Foundation would not be involved in the governing-justly category. It would be involved in the economic-freedom category, if Congress so approves. I just wanted to clarify that because there seemed to be a misunderstanding. Thank you.

Mr. PAYNE. Great. Well, thank you very much. I am not even sure whether—maybe you can answer—has the Heritage Foundation ever had anyone visit Africa. Do you know?

Mr. SCHAEFER. I was there at this time last year, and I go every year and research for the index.

Mr. PAYNE. Okay. So you are with the Heritage Foundation.

Mr. SCHAEFER. Yes, I am, sir.

Mr. PAYNE. There are a number of groups that I mentioned before that do a lot in Asia, for example, the Far East Center; a number of universities have had a U.S.-Japanese program, for example, in other parts of Asia. In Africa, of course, you have groups like TransAfrica, Africare, Church World Service Africa Division, none of which I have heard mentioned at all. Then Freedom House

would be the one to do the just business. Okay. Well, I guess that is supposed to be reassuring.

My point is simply that it seems to me that we are not going to see these numbers of new dollars that we have said. I am just cynical, I suppose. Leave No Child Behind, H.R. 1; that was what President Bush ran on reforming. No child should be left behind, and they have already reduced the funding by 10 percent before the first year. Now, this Millennium fund that has gone over there; we have seen a 10 percent reduction in the 1.7 to 1.3. That is not your doing; you all do not do the budgets. And I could see the next year not quite meeting the goal.

I see USAID actually, for all intents and purposes, as out of business. There is going to simply be a new way, in my opinion, that we are going to do foreign assistance, and it is going to be MCA. Not even to have the USAID involved, even in an advisory capacity, to the board, like I said, does not make any sense to me, but I did not create this thing. I just see a reduction in funding for USAID, that money being reprogrammed over to MCA, and 10 years down the line there will be no more USAID, and it will simply be a sort of an MCA kind of group. Now, maybe that might be good, or maybe it would be bad. I do not know, but I think that that is probably where it is going.

But, anyway, I think I have exhausted my time. Thank you, Mr. Chairman. You have been very kind.

Mr. LEACH [presiding]. Your leadership on these issues is very significant to the Congress, and your perspective will have to be taken into consideration.

Let me just raise a couple of things before bringing this to an end, if I can. One, I think the big picture is that a new initiative, however it is structured, has to be accepted, has to be embraced sympathetically. Secondly, a new initiative that emphasizes the corruption issue is something that is extremely positive. Now having said that, whenever you come up with criteria, they become capricious, and so one of the questions is whether you can have some flexibility or should have flexibility. Let me mention a couple of things that have been brought to my attention.

The Administration, quite reasonably, is basing its criteria on some new World Bank Institute approaches. There are other groups that have attempted to do this thing, too. One is Transparency International. And intriguingly, if you contrast the two, I am told, of the 13 countries which appear likely to qualify in year 1 of MCA, one is ranked last for corruption by Transparency International, one is 89th, and one is 85th. Likewise, the Administration's approach would score Cambodia better in government effectiveness and control of corruption than democratic India.

I only raise these contrasts to underscore that there is a capriciousness to criteria, and so I think it would not be unwise to put in some flexibility. I want to ask if you would concur in that, or do you think that you need very precise standards, and there is an advantage to each? Would anyone have any comment on this? Yes, David.

Mr. BECKMANN. Well, I think the real accountability is not that a set of 100 bureaucrats in Washington are going to look at the ideal set of indicators. The real accountability is going to happen

in the country, which is why it is so important that the legislation give a much stronger mandate for democratic participation, including proactive efforts to involve disadvantaged groups in discussing how this MCA money will be used and implementing programs.

I think, Mr. Leach, the most powerful lesson of the debt-relief process of the last few years is that what was written into H.R. 1095 regarding debt relief mandated a much more participatory, consultative approach. Bread for the World is in touch with church groups in a number of countries that have received debt relief. Other church groups are in touch with church groups in other countries. So I have a high degree of confidence, from official channels and from grassroots channels, that debt relief really is working to reduce poverty. In many of those countries there are more kids in school and more medicines in rural clinics. In five or six countries, there have been significant improvements in democracy and reductions in corruption.

So building into the MCA legislation strong language that will make it clear that there be a participatory process in these countries is much more important to the overall likelihood that this money is going to be used well than fooling around with the criteria.

Mr. LEACH. I appreciate that, and let me just add because it is leading up to the next point, which is self-evident, that the concern for anybody providing assistance anywhere is for people, not for governments, and so if you have a government by some criteria that does not qualify, you, in effect, are punishing the people. It raises the issue, and debt relief tried to deal with that, but we also had criteria in the debt-relief legislation.

But in foreign aid, there is the obvious circumstance that our government and other governments around the world have struggled with: What happens when you have a disadvantaged people and an imperfect government? You try to come up with different mechanisms for delivery of services, and so you work with non-profit institutions and church groups and other types of institutions in other kinds of ways.

But I only stress that if you have no flexibility whatsoever, however you address the criteria, and I raised the criteria because the criteria of the group, Transparency International, is actually stiffer than the Administration's and, therefore, more constraining than the Administration's, but only to point out that the Administration's criteria have a degree of arbitrariness, too. But if you all of a sudden indicate that you will be excluding people of great need relative to people of similar need that have a fractionally better government based on some sort of criteria, you do have some inequities built in by definition into the system.

And so I am not at all sure that you should not have certain flexibility, particularly within the obvious, strenuous circumstances, but also there might be other ways of being punitive to governments. By that I mean that one might have criteria that say that if you do not meet certain benchmarks, no way that this country can go through a government. That does not mean it cannot go to the country. What would your judgment of that be? Is that what we are really getting at? And that should be very embarrassing to the government and should cause the government to

think that through. Does that make sense? It is disempowering the government, but it is not ignoring the plight of the people. Doctor?

Mr. RADELET. I think the idea of different delivery mechanisms in different countries is exactly the right way to go and that this is a first step along that way. I do not think it is a good idea to use this kind—

Mr. LEACH. But this proposal is a little more capricious. As I understand the model, it will only go to countries with governments that meet standards.

Mr. RADELET. That is right. There are several things in your question. I think it makes sense for countries that have shown some improvement in good policies and good institutions to give them more flexibility and use a delivery mechanism like this. Right now, in the Administration's proposal, they are proposing one contract with the recipient government. I think that is a mistake. I think that they should open it up in those countries to subnational governments, to NGOs, and to others. That is one point.

Second, for countries that do not meet the government test, we should think about different delivery mechanisms and effectively delivering it around the government, maybe the subnational governments, if they make the test, the municipal governments, or to NGOs. So I think that makes a lot of sense.

You are also right in the point that you make about the data being somewhat capricious and the need for some discretion. Now, discretion can be a good thing; it can be a bad thing. So when you enter that, you have to be careful about it. I am quite sure that this data is not strong enough or robust enough that it should be absolutely done only by the numbers. That would be a mistake. There should be some discretion so that countries that are on this list that should not be can get knocked off, and a few countries that do not make it maybe should be added on, but when we introduce that discretion, we have to be very clear under what circumstances the Administration should and should not be able to do that because we do not want our latest friend to be added to this list just because they are our latest friend.

So I think you do need some limited discretion. It has got to be very open and transparent why they are doing that. You and your Committee should expect strong reporting back from the Administration as to exactly what they are doing, and if you couple that with having different delivery mechanisms, I think you would vastly improve the way the programs work.

Mr. LEACH. Let me ask you, because I have not examined this legislation closely, are you suggesting that it only goes to governments?

Mr. RADELET. The way that they have written it up, they are talking about a contract. The language they have is "with a qualifying country." Now, I do not know how you can have a contract with a country, so, presumably, it is with the government, although they have not been very clear about that.

What they propose is that the recipient countries, once they qualify, would have a process where governments, nongovernments, municipals, subnationals would get together, think about a lot of proposals, and bring all of those together into one overarching program and that there would be one single contract between our gov-

ernment and their government, their country, that would oversee all of that. And they allow for the possibility that some of that could be implemented directly by nongovernment institutions, so implemented by nongovernments, but there is still a single contract.

I would like to see it opened up so that subnationals, different cities, different states can qualify directly, can propose directly, as well as NGOs. Just as a quick example, in South Africa, which might qualify in the third year, there are different governments in the Federal level, which is the ANC, and Kwazulanato State, which is a different government, and they are having conflicting opinions. It is a democracy, a very vibrant democracy, but one could thwart the opinions of the other just through political kinds of factors. I do not think we want to get involved in that, so that is one step where I think this could be improved.

Mr. LEACH. Thank you. Yes?

Mr. BECKMANN. If I can try again, the Administration is clear that they would not be mechanical in applying these indicators. What they want is to have publicly available data, partly to provoke a debate in countries about what would be needed to get this money. There would be debate within countries about how they are doing in terms of corruption, or how they are doing in terms of investing in education and health? The Administration is also quite clear that there would be an element of judgment involved rather than a mechanical application of data.

Also, there is some logic to the idea that this money would be allocated on the basis of how well the country as a whole is doing in these various areas. I think that the evidence is pretty clear that it is very difficult for foreign agencies to spend large amounts of money effectively in poor countries that have really bad governments.

On the contrary, I have been struck that in a country, say, like Ghana, where the government is a pretty wholesome government, all kinds of outside agencies can get good results doing development work, partnering up with various institutions.

So this additional money would go to countries like Ghana or Uganda where the government's overall thrust is really wholesome. That makes some sense. But then I agree entirely that it is really important that the legislation be clear, that this not just be government-to-government transfers but that there be various channels by which this money actually gets out to benefit poor people.

Finally, I want to return to the point I started with, which is that in the end the quality assurance is not going to be anything that happens in this room or in some other place in Washington, DC. The quality assurance is going to be what happens in that country. So what the legislation says about steps to ensure the monitoring and participation by society in these countries, especially disadvantaged groups, is an important complement to the heavy emphasis of the Administration on indicators.

Mr. LEACH. Thank you very much. Don, did you want to add anything?

Mr. PAYNE. Yes. Just the same line of questioning. I think it is fantastic. If you are going to send \$5 billion of the new money overseas, that is terrific. Nobody can knock that. However, I still con-

tend that you are going to have a lessening of USAID funds. You are going to have big bureaucracy. You are going to have some very well-placed firms. When you start subtracting the costs of 100 countries, 16 criteria, that is 1,600 questions alone being evaluated. Faulty data. Burundi, the Congo—they have not had a census since Patrice Lumumba was killed in 1962. How do you validate the information. Burundi probably could not even do a census.

Even Uganda; you mentioned how things work well there. Uganda is ineligible. Heritage has them, and I do not know how you guys did it—they say Uganda is ineligible, and they have done more things right, in my opinion. However, the President says, when we have multiparties, they became ethnic. We had Mobutu, we got an Ameen, and we had civil war; so we did away with parties.

Contentious elections. I have been there during elections. They are vicious politically, and the President of this one-party system had had a runoff. Now, if it was so rigged, and I am not a Museveni fan necessarily, but if the one-party system was so bad, there would not even have had to be a runoff. Museveni would have won by 95 percent of the vote, but he had to go into a runoff election, and at one point he thought he was losing. He did finally win, miraculously some way. However, Uganda would be ineligible. Yet they can make it. They grow food. They manage. It is, you know, a semblance of roads that are paved in some areas and so forth.

But take Haiti. In 100 years, Haiti would not qualify. So you say, let USAID do it. Well, USAID is not doing anything now. So if you have \$5 billion, and you are going to say Haiti is off—USAID is doing zero there now—you take that \$15 billion of foreign aid that we give, and two-thirds of it is for military or for nonhumanitarian issues. So what is left?

You are not going to tell me, even with this \$10 billion of new money for HIV/AIDS, already we are finding it is not new; some is reprogrammed. It is certainly going to be more than what was there before—there is no question about it—even if we get half of the \$10 billion, but it is not going to be \$10 billion of new money. That is a fact. And as we see this corporation grow, and we see the bureaucracy grow, and we see contracts being let, and we see consultants going down doing the evaluations, what is going to be left? We see USAID beginning to diminish—if they thought USAID was important, they would be on the board. I would not ask Natsios. Why would I ask him? Don't you think you should be on the board? He would probably be fired by tomorrow. That would not be a fair question.

But how are you going to have an MCA board within the State Department? It was brilliant to put in the U.S. Information Service. The leadership of the House said, "We need to eliminate USIA. U.S. Information is not important. Let us put it in the State Department." Have not heard of USIA since. The former President of one of the colleges up in New England, President Duffy, was the head of USIA. I think he came from—I do not know—one of the Boston colleges. They put it in the State Department. I have not heard about it since, and all over the world the United States has

the most disinformation going. Closed libraries, closed things that gave America's story out when it was an independent agency.

Now we are trying to figure out how do we get our story out to combat Al-Jazeera and all of this other stuff when we could have strengthened and emboldened the United States Information Agency. So we put it under State, and when things get under State, they become submerged. State is so big. It is in another place down in the basement somewhere.

I love the State Department, but, as a matter of fact, the State Department is the first thing that has needed to be reformed, for the last 50 years. Of course, I like the new, present Secretary of State. I think he is a great American, Secretary of State Powell. However, the agency is just besieged with lack of reform. I mean, you have all heard it.

So now this agency is going to be under the State Department. I just think, in the long run, we are really going to be missing the boat on a lot of the truly needy. There is no way Haiti, and I use that as an example since it is so vivid, could ever in 100 years qualify. So as USAID money dries up, they just will be in worse shape.

Mr. LEACH. Thank you. Let me bring this to a close, but I want to close, and I know David has the title of Reverend, with this aspect of morality. There is a moral issue that is tied up with the word, "corruption," and we, as a society that considers itself civilized, have to be concerned with it. But when you come to the distribution of aid, there are conflicting moral circumstances for which presumption from America's shores have to be weighted.

The real moral issue is how you feed a 5-year-old kid, how you get an 8-year-old to learn to read. If we come up with a foreign policy based upon a moral presumption which is totally valid, that the only criteria is corruption, we also come up with a foreign policy that ignores certain people, and that causes another moral dilemma. I just raise this as carefully as I can because we are all very much concerned with the corruption problem, but we are also concerned with the second moral issue. If you weigh the two, one can certainly observe, as Reverend Beckmann has, that societies that have corrupt governments are not very efficient, and so your money is likely to be less well used. So then do you throw up your hands completely or not? I just think, in this regard, what Congressman Payne is saying in other ways has to be measured as we look at programs of this nature.

I want to thank you all for your testimony and your thoughtfulness and your careers and your efforts. They are appreciated by the Committee, and on behalf of the Committee, I apologize for the processes of Congress that caused you all to wait for an hour as the Congress dealt with some voting on the Floor. In any regard, thank you all very much. The Committee is adjourned.

[Whereupon, at 2:15 p.m., the Committee meeting was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE JOSEPH R. PITTS, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman, thank you for convening this important hearing today to discuss the President's foreign aid initiative. America is a blessed country—one with great wealth and freedom. Therefore, we have a responsibility to help others around the world who are less fortunate.

While many developing countries have taken great strides in improving the living condition of its people, too many are still untouched by progress. One half of the world's population today lives on less than \$2 a day.

For billions of people, especially in Africa and the Islamic world, poverty is rampant and per capita income is falling. In Sub-Sahara Africa, HIV/AIDS is a crisis we can no longer afford to overlook.

While we must be generous, we must also be wise. The President's Millennium Challenge Account is about good government. Under the President's plan less-developed countries will be eligible for grants based upon deeds, not words.

To receive additional aid under the plan, countries must demonstrate results in adopting reforms necessary for economic growth, poverty reduction, and the rule of law.

Further, the plan ensures that development assistance is directed to those who will use it effectively. It avoids a bureaucracy that wastes too much of our foreign aid money and prevents the aid from reaching the people who need it the most.

But for the Millennium Challenge Account initiative to be successful it must be closely tied to efforts to strengthen partnerships between governments and NGOs and build relationships through public diplomacy. The Millennium Challenge Account is a bold new approach to foreign aid—an approach that is long overdue.

I look forward to moving an authorization through this committee and working to transform U.S. development policy.

PREPARED STATEMENT OF THE HONORABLE JOSEPH CROWLEY, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF NEW YORK

Thank you Chairman Hyde and Ranking Member Lantos for conducting this important hearing. I also would like to thank the witnesses for briefing the Committee and answering our questions today.

The Millennium Challenge Account has the potential to do much good throughout the developing world, and I welcome the Administration's thinking out of the box on how to reinvigorate assistance to the developing world. But, while I welcome the program in theory, I have concerns about this program in practice.

While the President claims to support fully funding the MCA, he has already decreased his initial commitment by \$370 million. Additionally, despite the President's earlier promise that he would dedicate entirely new funds for the MCA, the President's FY04 budget, by withholding an increase for inflation from existing foreign aid programs and requesting amounts lower than those enacted in FY03 for core bilateral development activities, clearly funds the MCA partly from existing programs.

This looks to me to be another case of this President and his growing credibility gap.

Let me say, I am excited to see this authorizing legislation and work to develop a program that ignores the political rhetoric we have seen over the past two years and actually recognizes the existence of other countries in the world.

As Co-Chair of the Bangladesh Caucus, I am pleased to see that Bangladesh will meet the requirements to be one of the first countries to participate in the program. I am troubled to see that Armenia has not been included as an eligible country for the MCA. In my opinion, Armenia fulfills all the indicators to allow them to be eligible for MCA funding, and I believe they should be given a second look.

There is some here to celebrate, and much to question, and I appreciate you all appearing here before us today. I look forward to hearing all of you discuss the MCA.

Thank you.

PREPARED STATEMENT OF THE HONORABLE NICK SMITH, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF MICHIGAN

I want to thank Chairman Hyde for holding this hearing today to discuss the President's Millennium Challenge Account program. I would also like to thank the administrators of our current aid programs who are joining us today.

The President proposed The Millennium Challenge Account (MCA) to fight poverty by giving more money—40 percent more money—to developing nations. The President knows that the problem with government programs is not usually quantity, but quality. Therefore, the MCA is designed to reward countries that are reforming their economic, legal, and political systems to increase transparency and freedom. It also provides incentives to countries to reform. The recipient provides the quality, and we provide the quantity. The principles are simple, but the implementation is unclear. We need to measure the performance of countries and programs to guarantee that our money is being spent wisely. We also need to understand precisely what the goals of the MCA are, in relation to other aid organizations. The last thing I want to do is impose another confusing and contradictory bureaucracy on people that we are trying to help. Our goal must be to implement the President's vision efficiently, simply and effectively.

One of our tasks should be to make sure that these countries are getting scientific information regarding the safety of biotechnology with food products. Biotechnology holds great promise for developing countries to produce more and healthier food crops from new E.M. seeds.

When we give aid to countries that have reformed their economic, political, and legal systems, we are trying to inject capital where it is most likely to be productive. But just because the countries are ready, it may not mean that particular programs are. We must expand the President's criteria to help us measure the performance of the programs that we fund. And then we must guarantee that the countries and programs continue to meet their performance objectives.

Another task is to describe precisely the goals of the MCA, relative to other aid programs. The State Department provides aid in support of our strategic objectives. The MCA would provide aid to reduce poverty and encourage free markets and democracy. Where does this leave USAID? Similar problems appear between the international development organizations, where there have been some turf battles. We need to rationalize our aid programs and establish clear goals that we can accomplish.

As we study these possibilities, we should remember that there are other, effective sources of aid beyond the federal government. By some estimates, individual Americans and corporations give 4 to 5 times the amount our federal government gives to the developing world. This is about 50 percent of the total amount given by non-governmental organizations. This money goes to building that school, educating those children, and digging that well. These programs work, and I suggest that we learn from them. At the very least we need to consider how to coordinate these organizations with the MCA.

Again, let me thank our guests for joining us today. I look forward to hearing their advice. The President has stated laudable goals. Now we have to do something that we are not very good at—designing an efficient, simple, and effective government program that passes out money.

