

A New Hope:
The Millennium Challenge Account and the Future of Foreign Aid

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Introduction

Modern foreign development assistance, or foreign aid, dates back to World War II. After World War II, Europe experienced an economic crisis. Fearing that Europe would turn to the immediate promise offered by communism, the US formulated the Marshall Plan to reconstruct Europe with the aid of US capital and institutions such as the recently founded International Monetary Fund and the World Bank.

Economists tried to accelerate economic growth in countries where private capital was scarce by emphasizing the importance of national development plans, which could serve as “general guidelines for how scarce domestic and foreign resources could be allocated¹”. They hoped that foreign aid would complement local savings and that the increased resources would allow the government to accelerate economic and social developments. The governments could create jobs for the rebuilding of public infrastructure and housing.

The success of the Marshall Plan led to the continuance of foreign aid programs. In 1961, President Kennedy established the Agency for International Development (USAID), following the passage of the Foreign Assistance Act. President Kennedy provided a justification based on three premises:

(1) then current foreign aid programs, "America's unprecedented response to world challenges", were largely unsatisfactory and ill suited for the needs of the United States and developing countries, (2) the economic collapse of developing countries "would be disastrous to our national security, harmful to our comparative prosperity, and offensive to our conscience", and (3) the 1960s presented an historic opportunity for industrialized nations to move less-developed nations into self-sustained economic growth².

However, little of the anticipated progress has been achieved with foreign aid. Foreign aid became increasingly politicized, used to prop up brutal dictators in exchange for their support in the Cold War. Billions of dollars poured into developing countries, with little result. ‘Aid fatigue’ resulted, as disappointment tempered with few success stories raised doubts even among the left about aid’s effectiveness³. But just as foreign aid was languishing in political limbo, the attacks of September 11 illuminated the alternative: failed states such as Afghanistan served as breeding grounds for resentment, hate and highly motivated and well-trained terrorists. Often,

the citizens of these countries respect democracy, anti-corruption campaigns, economic and educational freedoms, but feel that the US, for all its talk, has not helped them achieve these goals⁴. Foreign aid was suddenly seen as useful, a way of fixing and preventing the desperate straits that led to the will for terrorism. No longer was the question ‘why should foreign aid exist’, but ‘how can it be made more effective’. In an attempt to answer this question, the Bush Administration has proposed the Millennium Challenge Account.

The Millennium Challenge Account

In March 2003, President Bush proposed the sorely needed revitalization of US development aid through the establishment of the Millennium Challenge Account (MCA), an aid fund managed by the new government corporation, the Millennium Challenge Corporation. The MCA would provide \$5 billion a year to a small group of countries; a fifty percent increase over current aid spending. One major caveat, however, is that the account’s resources and funding will go only to countries deemed to be “ruling justly, investing in their people, and establishing economic freedom⁵”. This is based on the theory, supported by a growing body of literature, that aid is an “effective instrument against poverty- so long as the recipient countries are characterized by the right political will, appropriate policies, institutions and governance⁶”. By basing disbursement of aid on the existence of these conditions, the Bush administration hopes to reward poor countries who help themselves, while providing positive incentives to those who miss the mark to improve enough that aid can truly make a difference.

Qualifying for Aid

The Bush Administration has selected 16 indicators that will be used to measure a country’s policies and commitment to development. Groups of countries that qualify based on income will then compete to qualify for the MCA based on their respective scores. In the first year, only countries eligible to borrow from the International Development Association which have a per capita income below \$1435 will be compete. In the second year, the IDA eligibility will be dropped, and any country with per capita income under \$1435 can try to qualify. In the third year, as funding increases all countries with incomes below \$2975 will be eligible to compete in

a pool separate from the poorer countries. All will have to score above the median on half the indicators in each of the three policy areas of governing justly, investing in people, and encouraging economic freedom.

The 16 indicators, as grouped by area, include⁷—:

Governing Justly:

- Civil Liberties
- Political Rights
- Voice and Accountability
- Government Effectiveness
- Rule of Law
- Control of Corruption. Control of corruption is a unique indicator, as a country must pass it in order to qualify for the MCA, regardless of its overall score.

Investing in People:

- Public Expenditure on Health as a Percent of GDP
- Immunization Rate for DPT and Measles
- Total Public Expenditure on Primary Education as a Percent of GDP
- Primary Completion Rate

Encouraging Economic Freedom

- Country Credit Rating
- Inflation
- Budget Deficit/GDP
- Days to Start a Business
- Trade Policy
- Regulatory Quality Rating

Based on the proposed indicators and income levels, Steven Radelet of the Center for Global Development calculated which countries would be eligible for MCA aid. He notes, however, that the final list for the MCA might be somewhat different from his, as a country's particular rating, or even the average, may change. In addition, the MCA staff may allow those countries that miss only by a mark (excluding corruption) or are missing data to qualify and compete anyway. Table 1 shows all countries within the income range specified by the MCA, broken down by region. Table 2 shows the qualifying countries under the administration's current methodology of mean scores⁸—.

There has been criticism of this proposed methodology, however. Radelet noted that changing even the requirement of scoring above the median would include Cape Verde, the

Gambia, Ghana and Guyana, thereby increasing qualifying African countries⁹. Even an above the average score is kept as the qualifying mark, the MCA staff should have the ability to expand the pool. This will open up the MCA to those that miss by one mark as well as those countries that are missing data figures.

A more controversial criticism, however, has been that of the corruption indicator. Lael Brainard and Allison Driscoll of the Brookings Institute feel that since many of the countries disqualified by the corruption indicator are from Sub-Saharan Africa, this absolute requirement should be dropped. Admittedly, it is problematic that these countries are denied aid this way, but the purpose, and key to success, of the MCA is that it supports those countries who legitimately try to develop themselves. Countries with corrupt governments by their nature can not be trusted to spend the MCA money. Removing the corruption indicator, or even making it less than absolute would undermine the effectiveness of the MCA, dooming it to the same vicious cycle of aid perpetuated by USAID and the World Bank.

Disbursal of Aid

Once a country has qualified for the MCA, it must then submit the equivalent of a grant proposal for a specific program. A country can submit more than one proposal; one for a health program, another for education funding and so on. The proposals are then reviewed and compared to other proposals in the same area; all health proposals, or even all HIV/AIDs programs compared. If a country's proposal is rejected, it has the opportunity to resubmit it after suggested improvements are made. The idea behind the approval process is not to limit the amount of money disbursed, but to ensure that the best possible program is enacted. Countries are accountable for their programs, and their qualifying status can change depending on the success (or failure) of a program, as well as their own economic and political actions. In addition, the proposal process helps government agencies develop the skills for designing and implementing successful programs that they will need once they graduate from the MCA.

The Millennium Challenge Corporation

The second part of Bush's proposal is the creation of a new government corporation to manage the MCA. The Millennium Challenge Corporation (MCC), as it is called, has already sparked quite a bit of controversy. US foreign aid programs are managed by several different agencies and departments: the State Department, USAID, the Treasury Department (which serves as liaison to the IMF), as well as several smaller groups such as the Export-Import Bank, the African and Asian Banks, etc. The MCC would add yet another agency to this mix, requiring a new staff, headquarters, and other aspects of an expanding bureaucracy. More notable, however, is the quite deliberate snub to USAID. USAID, the primary development agency in the US, is viewed by many as too bureaucratic, too burdened with Congressional missives and politics. And this is true. USAID has become increasingly ineffective. The MCC, as the 'corporation' in its name implies, is intended to be a much more streamlined and cost-effective agency. The Bush administration has proposed a staff of only 100, most of whom will contract out from USAID, NGOs and private business. While this number is impossibly small, after considering that at least 2-3 field officers are required per country, in addition to basic management staff, area experts, and US-based country experts, the message is clear: the MCC will quickly and competently disburse aid funds.

There is another, more important reason to manage the MCA separately from the State Department, and even USAID. Foreign aid became increasingly political during the Cold War, supporting terrible dictators as long as they were anti-Communist, and ignoring far more deserving countries who accepted aid from the Soviet Union. The MCA is intended to focus solely on development, for the reduction of poverty. If the MCA was under the State Department, there would be increasing pressure to qualify political allies, or to funnel more aid to allies' programs at the expense of the other MCA countries.

The MCA and Future Aid

The attacks on September 11 demonstrated the terrible consequences of failed states and extreme poverty, and revitalized the call for foreign assistance, even among conservatives. The MCA marks one of the first steps on this new approach to development, but it only goes so far. While

the countries that are eligible to qualify for the MCA are obviously poor, their governments are still steadily working towards development. Assuredly, even the best scoring MCA countries could backslide, due to a change of government or even the weather, but the basic framework exists. The greater danger is for those countries that do not qualify for the MCA, whether by missing or averaging one mark, or by failing the corruption standards. These countries that barely miss any mark other than corruption could be included in the MCA, as discussed earlier, or they will work to raise their standing for the next year. It is the countries that fail many of the standards, most of which are in Sub-Saharan Africa, that most desperately need assistance.

The MCA is not designed to help these countries, and neither should be changed so that it does. Doing so would weaken the MCA's effectiveness in helping those countries that already qualify. Instead, other aid agencies must step up. However, by managing the MCA under the separate MCC, the Bush administration has created doubts about the capabilities of USAID, the most likely agency to help non-MCA countries. The criticism of USAID is legitimate, and in other circumstances might lead to the eventual 'phase-out' of the agency. But the recognition that development aid is imperative for the future security and health of the world must also come with the recognition that more than just the MCA-qualifying countries must be helped. Short of creating yet another government agency, USAID is the only option.

Therefore, in order for USAID to be *viable*, several changes must be made. First, USAID must adopt a narrower range of activities. Economic growth can include everything from education to cash flows to privatization to dams, and USAID attempts to cover all of these areas and more. To quote Radelet, "It must learn that just because a problem exists in a developing country, does not mean USAID must fund a program to solve it¹⁰". The agency has a strong background in health, education, agriculture and humanitarian aid, and it is in dealing with these areas that it will be most effective. Since corruption is also a major problem in many developing countries, and there has been heated debate over the legitimacy of the influence that the IMF and the World Bank have in this area, USAID should continue its work with 'good governance' programs. Unlike the MCA, USAID would retain most of the control over these programs, until the government was

developed enough to take over management. In some cases, management might even be turned over to NGOs, in order to provide more local accountability, despite weak or corrupt governments.

USAID also requires more flexibility, with fewer Congressional directives and political earmarks. By making USAID less bureaucratic, it can become more effective and competent in designing viable programs, significantly improving its performance. USAID's focus must shift back towards development, rather than political pandering. As USAID demonstrates its growing effectiveness, it should be given a larger budget, to expand its programs (but not its areas) to bring more of the poorest countries to MCA-qualifying levels. Eventually, as USAID is reformed, it may be combined with the MCA under a larger, development department, but still separate from the security and political pressures of State.

The future of US foreign aid depends on the success of the MCA. If the MCA does what it is intended to do- raise poor countries to a reasonable level of development- then Congress and future administrations will be more likely to expand the scope of development projects. While at first the MCA may subtract resources from USAID's budget, eventually, the two agencies should work together to eliminate poverty/. Having graduated from USAID, countries will qualify for the MCA, receive more targeted funding, greater accountability and training in self-management, and eventually become good investments for private companies and banks. At that point, financial assistance can switch from direct aid to loans, without the risk of creating crippling debt. Moreover, the MCA can be viewed as US leadership in the fight against poverty. Although the US may not associate as closely with the United Nations as Europe, the MCA and USAID can find common ground with UN programs, as well as programs funded directly by other governments. International aid as a whole will be revitalized.

Conclusion

Foreign aid has had a checkered past, often disappointing both donors and recipient countries. However, the proposed Millennium Challenge Account brings new hope to those who believe that aid can be an effective means of combating mass poverty and reducing the

incentives for terrorism. Through careful management, country-owned proposals which lead to greater accountability, the use of public indicators and a large budget, the MCA has the potential to completely revitalize foreign aid. The discouraging endless cycle of donors rewarding corrupt governments in developing countries with aid despite broken promises to reform will end, but neither will governments that tried to improve their peoples' standards of living be left open to the vagaries of life that can so quickly make even a relatively well off country desperate. Those who will put use the aid to foster genuine development projects can receive it. More importantly, if the MCA is successful, agencies such as USAID may also see their budgets increase, and those countries that do not qualify for the MCA will also be better served. The MCA has the potential to begin a whole new era of foreign assistance, if it is allowed to function as proposed.

Works Cited

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4 Leonard, 8.

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6 Burnell, 6. Burnell cites the World Bank's *Assessing Aid. What Works, What Doesn't, and Why* (1998).

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10 Radelet 2003b, 159.