

**THE MILLENNIUM CHALLENGE ACCOUNT:
A NEW WAY TO AID**

HEARING
BEFORE THE
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
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THE MILLENNIUM CHALLENGE ACCOUNT: A NEW WAY TO AID

TUESDAY, MARCH 4, 2003

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room SD-419, Dirksen Senate Office Building, Hon. Richard G. Lugar (chairman of the committee), presiding.

Present: Senators Lugar, Hagel, Chafee, Brownback, Alexander, Coleman, Sununu, Biden, Feingold and Bill Nelson.

The CHAIRMAN. This meeting of the Senate Foreign Relations Committee will come to order. Today the Foreign Relations Committee will examine President Bush's proposal for a new mechanism to deliver foreign assistance. It is called the Millennium Challenge Account, or MCA.

President Bush's calls to establish the MCA come at a time when a reassessment of foreign assistance is badly overdue. American foreign assistance programs lack unifying objectives or coherent criteria. Too much of our foreign assistance is determined by obsolete cold war imperatives, the vestiges of our responses to past humanitarian emergencies, or domestic political inertia.

In my judgment, the primary goal of American foreign assistance must be to combat terrorism. And in some instances, this requires direct military and economic aid to key allies of the war on terrorism. But our foreign assistance must also be aimed at broader objectives that aid in the fight against terrorism over the long run.

These include strengthening democracy, building free markets, and encouraging the civil society in nations that otherwise might become havens or breeding grounds for terrorists. We must seek to encourage societies that can nurture and fulfill the aspirations of their citizens and deny terrorists the uncontrolled territory and abject poverty in which they thrive.

To do this, all of us should begin to think about foreign assistance as a critical asset in the war on terrorism. In this context, an ineffective foreign aid program squanders our anti-terrorist assets just as surely as does a poorly designed war plane or an unnecessary military base or a flawed intelligence collection operation. It is up to this committee—and ultimately every Member of Congress—to cooperate in the construction of the most potent foreign aid strategy possible.

Now, this process will require us to ask how nations develop political stability and economic momentum, and how they become

good international citizens that contribute to the peace and prosperity of the world community.

The Millennium Challenge Account is being established on the bold assumption that we do know some of the answers. We believe that successful societies cannot be built without good leadership, without economies based on sound market principles, and without significant investments in health and education.

The MCA will provide aid designed to jump start rapid economic growth in low-income countries that pursue sound policies. By establishing firm criteria to measure and reward the progress of low income nations in these areas, the MCA can provide a powerful incentive to foreign governments to embrace and to sustain reform.

As we encourage nations on every continent to join us in reshaping the world, the MCA would put our money where our mouth is. The President's proposal envisions \$1.3 billion for the account this year, with an increase to \$5 billion by its third year.

The President should be commended for proposing this new and creative departure in our foreign assistance programs. He is demonstrating a strategic understanding of the broader fight against terrorism and the altruistic American desire to help others achieve the prosperity that we are fortunate to enjoy in this country.

As we begin our deliberations on granting the President authority to establish the MCA, I would offer the following guidelines.

First, the MCA cannot be funded at the expense of other programs. Top priorities, such as HIV/AIDS funding and food programs for the hungry, cannot take reductions to make room for MCA funding. Neither can assistance be reduced to key countries like Afghanistan, which are unlikely to qualify at this stage for MCA participation.

Second, an optimal division of labor must be found between MCA and the United States Agency for International Development. Failing or failed States need more attention, not less, and USAID must be given the resources to address these complex situations.

Third, the Administrator of USAID or his representative should have a place on the board of the MCA. USAID has experience developed over decades that should be included in the expertise undergirding the MCA.

Other central questions that we will address today include how the MCA might coordinate with other bilateral or multilateral donors, whether it will need to have representatives in the field and whether it will be useful for outside experts to serve on its board.

To examine these and many other questions, we are fortunate to have two expert panels with us today. From the administration, we will be hearing from Alan Larson, the Under Secretary of State for Economic, Business, and Agricultural Affairs; John Taylor, the Under Secretary of the Treasury for International Affairs; and Andrew Natsios, the Administrator of the Agency for International Development.

On the second panel, we have three distinguished citizens from the private sector: Dr. Steven Radelet, Ms. Mary McClymont, and Ms. Susan Berresford. We welcome you all and we look forward to your insights. And I call upon now in the order that I introduced you—and first of all, Under Secretary Larson—for your testimony.

**STATEMENT OF HON. ALAN LARSON, UNDER SECRETARY OF
STATE FOR ECONOMIC, BUSINESS AND AGRICULTURAL AF-
FAIRS, DEPARTMENT OF STATE, WASHINGTON, DC**

Mr. LARSON. Thank you very much, Mr. Chairman and Senator Hagel, it is a great honor to testify on behalf of the Millennium Challenge Account. I do have a statement for the record, but with your permission—

The CHAIRMAN. It will be published in full and I would say this to all the witnesses, your statements will be published in full, and we would ask you to summarize as appropriate.

Mr. LARSON. Perfect. Mr. Chairman, last March, President Bush caught the world's attention when he called for "a new compact for global development" that would link greater contributions from developed countries to greater responsibility from developing countries.

It was not just the amount of money that attracted interest. It was also the fact that the Millennium Challenge Account brought together lessons about development learned over the last 50 years.

The MCA targets countries that govern justly, invest in the health and education of their own citizens, and encourage economic freedom. By focusing on those countries whose own policies encourage growth, MCA assistance will deliver much greater economic development. And for those countries that do not initially qualify, it provides a strong incentive to adopt growth-enabling policies.

The MCA proposes a true partnership, one in which participating, developing countries with the full involvement of their own citizens will set forth their own priorities and propose their own projects. And the MCA insists on results.

We will have business-like contracts with each partner, and we will 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, engaged in an intensive, year-long process of policy formulation. We received thoughtful suggestions from many, including NGOs and the business community.

Throughout, President Bush and his Cabinet gave unprecedented direct and sustained attention to the MCA and to development issues more generally. After a year of deliberation, we come to you with a number of conclusions reflected in the legislation before you.

First, the MCA should focus on promoting economic growth and developmental 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 that provide famine relief, that combat HIV/AIDS, or 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 in forming decisions about which countries will participate. Secretary Powell and the administration are committed to keeping the MCA firmly focused on development.

Fourth, the MCA should be administered by a separate corporation. Combining all of the new elements—selective qualification,

partnership, giving developing countries the lead, a business approach that measures results from the beginning to the end—all of this requires a new approach. The legislation therefore creates 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. To attract the best and the brightest personnel in public, private, and non-profit sectors, the MCA must have special personnel authority. To be lean and efficient, it must have the ability to contract broadly for services.

Sixth, the MCA must be accountable and coherent with other development programs. As chairman of the board of directors, Secretary Powell ensures—intends to ensure that the MCA is accountable to the President and to the Congress, and is well coordinated with the activities of USAID, which he also oversees.

Mr. Chairman, I would like to close on a personal note. My involvement with developing countries began 32 years ago as a school teacher in a self-help school in Kenya. Since then, as a diplomat, first in Sierra Leone, then in Zaire, then in Jamaica, I have run small assistance programs and promoted development initiatives like the Caribbean Basin Initiative.

On trips to every corner of the world, I have had an opportunity to observe a wide variety of developmental strategies. I am convinced that the proposal before this committee today is the most thoughtful and 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 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 also 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, Mr. Chairman.

The CHAIRMAN. Thank you very much, Secretary Larson.

[The prepared statement of Mr. Larson follows:]

PREPARED STATEMENT OF HON. ALAN LARSON, UNDER SECRETARY OF STATE FOR
ECONOMIC, BUSINESS AND AGRICULTURE AFFAIRS

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 process, 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 be-

tween 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 or 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 U.S. 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."

The CHAIRMAN. Under Secretary Taylor.

STATEMENT OF HON. JOHN B. TAYLOR, UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. TAYLOR. Thank you very much, Mr. Chairman and Senator Hagel for inviting me to testify on this very important and innovative initiative of President Bush's.

The Millennium Challenge Account is designed, as you indicated, Mr. Chairman, to reduce poverty and to raise income per capita around the world. And it is designed to do that by increasing economic growth and in particular by increasing productivity growth.

Productivity growth represents the ability for people to produce more goods and services. That ability to produce more is the source of rising incomes and reduction in poverty wherever it has occurred.

In countries where productivity growth has been strong, those countries have begun to catch up, even some have caught up to the wealthier countries. In countries where productivity growth is low or nonexistent, those are still the countries that are behind, in which there is still immense poverty. So the idea here, we think, is that by raising growth, we can take a real stab at poverty reduction.

The Millennium Challenge Account endeavors to raise economic growth by focusing on the policies that encourage economic growth, that bring down the impediments to investment flows, to technology flows that can raise productivity.

And as President Bush has stated, there are three types of policies that do this—policies that represent governing justly, policies that represent investing in people, and policies that represent encouraging economic freedom.

It is by encouraging such policies that the Millennium Challenge Account will raise economic growth.

The second part of the Millennium Challenge Account, as Under Secretary Larson has emphasized, is an insistence on measuring results, measuring the impact of the assistance as best as we possibly can.

And, of course, the third part of it is to actually increase the amount of assistance, as you have indicated, Mr. Chairman.

In my remarks here, I would like to focus on the way in which we are implementing the part of the program and the account that focuses on the policies that raise economic growth.

As Under Secretary Larson indicated, during the last year, there has been an extensive effort inter-agency in the U.S. Government, consultations with the Congress, consultations with other groups to develop a method to measure good economic performance and the policies that will raise growth. And on the basis of that—those consultations we have selected 16 indicators of policies that will raise economic growth.

In looking for these, we have looked at explicitly policies that we think correlate well with higher growth. We have looked at indicators that cover a large number of countries. We have looked for indicators that are widely available and for which there is transparency. And we have looked for indicators that are objective and sound as best that we can.

These indicators, which I will just briefly review, are not set in stone. We think they are good—very good indicators. But as the Millennium Challenge Account develops, there may be changes in the indicators themselves.

But just to review briefly, the 16 indicators cover governing justly, investing in people, and encouraging economic freedom. There are a total of six in the first category of governing justly. Two of them have been developed by Freedom House and have a long history. One is based on civil liberties, the other is based on political rights.

Four of the other indicators in the governing justly category have been developed by the World Bank Institute, and they cover issues such as the rule of law, measuring corruption, which is extraordinarily important from the point of view of encouraging economic growth, combating corruption.

There are four indices that we have focused on in the investing in people category. Two relate to health and two relate to education. For the education part, we look at the amount that a country devotes as a share of GDP toward education.

That is, of course, not the only indicator of good investing in people and education. Another measure is the completion rate for

young children in school, what is the completion for—a rate for them as they finish school.

With respect to health, again, a measure of the spending as a share of GDP on health. But since spending is not a sole measure of commitment by a country, we also want to look at the effectiveness as measured by the immunization rates with respect to certain important diseases.

With respect to encouraging economic freedom, there are a total of six indices, such as openness to trade, an index developed by the Heritage Foundation; an index of how long it takes to startup a business. That is a commitment to policies that we think are essential for economic growth.

We have a measure of good macroeconomic policies, keeping inflation low and stable, and keeping the budget deficit in line.

So based on these 16 indicators, we think we have found a reasonably objective way and a transparent way to measure policies that the countries are taking. Now, when these data are used, there are going to be gaps occasionally in them. They are not going to be perfect.

So the Millennium Challenge Corporation, when they use these data, will have to exercise some judgment in coming to conclusions of which countries are succeeding. What we have suggested in this is that countries have to be above the median in half of the indices in each category. That allows for some flexibility and for some judgment. But it is a rigorous objective way to apply the indices.

I think the most important thing about the indices is they are very transparent. They can be obtained from Web sites. People can do their own calculations to see how countries stand up. And perhaps most important, the countries themselves can see how they stand up.

I want to just mention briefly the other part of the Millennium Challenge Account and Corporation which is so important, and that is the emphasis on measuring results.

We expect that every contract will have outcomes that specify what is supposed to be accomplished in each country and each project. There will be specific baseline data of where things are at the start so that you can see what the improvements are.

And we would like the projects to be structured in a way such that it can be stepped up or changed or cut back depending on how progress is made so we can actually make adjustments if the goals are not being achieved. So by measuring results by insisting on performance and by actually increasing the amount of funding, we feel that the President's initiative can be more effective than any in the past in achieving the goals of raising economic growth and reducing poverty.

We feel the Millennium Challenge Account represents our country's greatest opportunity to transform the rhetoric of measurement and the rhetoric of development effectiveness into an operational action plan and we urge your favorable consideration of the Millennium Challenge Account Act of 2003. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Secretary Taylor.

[The prepared statement of Mr. Taylor follows:]

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

Chairman Lugar, Senator Biden, 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 2302 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 matters: 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."

The CHAIRMAN. Administrator Natsios.

STATEMENT OF HON. ANDREW S. NATSIOS, ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT [USAID], WASHINGTON, DC

Mr. NATSIOS. Thank you very much, Mr. Chairman and members of the committee. I would first like to ask that my longer written testimony be put in the record. But I also would note—

The CHAIRMAN. It will be published in full.

Mr. NATSIOS [continuing]. That we worked on the written testimony a great deal. It is more than just written testimony. It is actually the plan that we intend to use to integrate USAID into the Millennium Challenge Account. So I would urge the staffs to examine what we have written, because we went through a long process to get to the written testimony.

Thank you, Mr. Chairman and members of the committee for holding this hearing on the Millennium Challenge Account in such a timely manner. I know, Mr. Chairman, that you and other members of the committee, have had a great interest in what the President has called our moral imperative to combat world poverty. And I am delighted to participate in what I believe will be one of the most sweeping changes in foreign assistance funding since the Marshall Plan and the Alliance for Progress.

I would like to thank my colleagues, Under Secretary Larson and Under Secretary Taylor, for their excellent summary of the evolution of the MCA and on key issues, which I will not repeat.

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 the President'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 more coherent and coordinated U.S. development strategy.

For the first time, we have the opportunity to articulate and implement a government wide U.S. strategy that clearly and accurately defines our different challenges and matches the right tools to address them. The MCA will play a critical role in this process as we begin to define U.S. development assistance to address the very different challenges we face today than those that we faced during the cold war.

Specifically, MCA puts into practice what we know works in development. As both my two colleagues suggested, the MCA is the direct outgrowth of what USAID and other development actors have learned over the past 40 years. Simply put, development assistance in poor countries that are pursuing good policies produces growth.

We know that good governance, economic policies, and institutions are key. Country ownership of the development agenda is also essential. 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 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 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.

This is particularly true of governance. Experience has taught us that no amount of money can overcome corrupt local leaders or the absence of political will for reform. I might add here that one of the most powerful parts of the President's approach is to support the forces of reform in the developing world.

Every country in the world, whether or not it is the most autocratic, has some force that wishes to change the society and reform it. And the problem frequently is that the reformers feel isolated. They do not have tools. I know already in parliaments in the developing world, this piece of legislation is being used to argue for immediate changes to deal with their problems or they will not be eligible for the MCA. So even in countries that are not MCA eligible,

this legislation will have a profound effect on the policy reform process.

It puts a tool in the hands of reformers, the very people we want to support to try to make the changes in their society so that they can get the local policies on their own without us forcing them to do it. And it is a very powerful tool.

USAID will reorient its assistance programs to take into account the principles 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, it also gives USAID the opportunity to clarify its role and better focus its activities within the context of a coordinated strategy.

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 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 that USAID should focus activities on four broad categories of countries.

The first is the countries that just miss getting into MCA. There are a number of countries that are just below the requirements in terms of the 16 indicators.

The second are mid-way—mid-range performers with the will to reform, but that are a little further down in terms of qualifying.

The third are failed and failing States that need post-conflict, transition, or humanitarian assistance.

And finally there are countries requiring assistance for strategic national security interests.

For the first group of countries USAID will concentrate on the specific areas that require strengthening for MCA eligibility. For example, if a country is not investing sufficient resources in its people area or achieving good results in this area, USAID would concentrate its programs in that particular sector.

In the second group of countries that are unlikely MCA candidates in the near future, we will 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.

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 our broader assistance programs.

In the third category, USAID has responsibility for failed and failing States that do not lend themselves to assistance guided by MCA criteria. We are actively developing new assistance models within this particular category of country that will integrate emergency relief, food assistance, governance reform, and civil society building.

We have restructured our humanitarian assistance bureau to create a new bureau called Democracy, Conflict and Humanitarian Assistance to put democracy and conflict offices in the same office as

Food, Transition Assistance, and the Office of Foreign Disaster Assistance.

In 2004, we have requested over \$2 billion for these crisis countries and that is a substantial increase over what we have done in the past.

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

Finally MCC programs will be founded on a partnership and driven by country demand. We stand ready to adapt our programs to support the MCC.

If a country selected for MCC funding has a USAID mission and program, we would undertake a strategic review of the existing portfolio of projects. In many cases, we would see the USAID program transition to support the MCC contract specifically.

However, there are critical global and regional threats, such as HIV/AIDS that would warrant continued support as they are. 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 through watershed management, transport linkages, or regional trade capacity building measures.

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

Mr. Chairman, I believe that President Bush's vision for assisting the developing world as embodied in the MCA creates a unique opportunity to prove that development done right can work. We urge the passage of the legislation. This concludes my testimony. I will be glad to answer questions.

The CHAIRMAN. Thank you very much, sir.

[The prepared statement of Mr. Natsios follows:]

PREPARED STATEMENT OF HON. ANDREW S. NATSIOS, ADMINISTRATOR, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

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 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.

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 U.S. 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 all together, 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 and conflict are at the heart of our response to failing states. We have also increased our funding levels. 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 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 wel-

come 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 U.S. 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 U.S. 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.

The CHAIRMAN. We will have a first round with 7-minute limits on Senators, and, if necessary, we will have a second round as we question this panel.

Let me start by saying that my understanding is that the countries under consideration for the new MCA program would have a per capita income below \$1,435, as well as the ability to borrow from the World Bank International Development Association. There are 74 countries apparently in this category.

But the criteria you have suggested, the 16, have led the Center for Global Development to estimate that only 13 countries would qualify in the first year. Now, that does not negate the value of the 16 criteria. It may be the purpose of the program to elevate the conduct of governments and their policies very abruptly, so that conceivably there might be just five winners.

But I just want to make sure my own understanding is yours, and that is the criteria appear to be substantial, even reasonable to Americans that other countries ought to have these humane and efficient policies that you have suggested, but most do not. In fact, a huge number do not, and especially among those countries that have fairly low per capita income.

Now, in answering that question, try to couple it with this. It is suggested, as I understand the MCA program, that by the third year, the income cap would rise to \$2,975. And some have suggested—and you have all done the math on this—that the in-

creased cap might qualify more countries, such as Egypt, Russia, Colombia.

If that is the case, then some very large entities may become a part of this, well beyond the small countries that are envisioned at least in the first track and the first year with perhaps substantially different policies of management. However, as Mr. Natsios has said, USAID will be integrating case by case, trying to think through what is already occurring, or if we are doing anything in these countries.

I wonder about the philosophy, please explain to us the thinking and then likewise, the very small staff. You have talked about a lean organization, and it certainly is. But will MCA have people in the field? How will they deal with the NGOs and with others who are intersecting so that life does not become very complex for the recipient governments contending with the various parties that are now all interrelating with each other.

Secretary Larson, would you have a crack at those questions to begin with?

Mr. LARSON. Thank you, Mr. Chairman. I will certainly give you an overview of our thinking. First of all, while it was premature to talk about any list of countries as such, because we do not have the latest data on these indicators and we will be running all of that later, I think it is correct to expect that the rigorous application of these indicators and criteria will result in a very selective program.

And we believe that is appropriate for a variety of reasons. First of all, the experience in development over the last 50 years has shown that we get much greater developmental impact, more bang for the buck, more kids completing primary school, for example, if we are investing our development assistance resources in countries with good policies.

Second, we do believe that as Andrew Natsios said that in countries that do not make the cut in the first instance, this set of very open and transparent criteria is already spurring ferment and change and pressures to improve policies in countries where those policies need improvement. And that is one of the very important goals of the Millennium Challenge Account.

We are going to make sure that we are in a position to help those countries that are trying to improve their policies and, again, Mr. Natsios has outlined the ideas USAID has for lending a helping hand to countries that are not quite where they need to be at.

In later years of the Millennium Challenge Account, we do imagine easing the per capita income level to something just below \$3,000 per capita, which includes what the World Bank calls the low-, medium-income countries. But there is a couple of points to bear in mind here.

First of all, these are still countries that have very serious problems of development and poverty, particularly for certain segments of their population. Second, we do not imagine these countries competing against the poorest countries. Our vision is that they would compete among themselves for a slice of MCA resources.

We believe that the focus of this program has to remain on promoting development and economic growth in the world's poorest countries, and that is where we intend to keep it.

Last, on the size of the Millennium Challenge staff, you are right in saying it is a lean staff. We want to work very hard to avoid a new bureaucratic entity. We are talking about short-term appointments. We believe that they may need to have a limited field presence, but we would also expect that in countries where USAID is present that USAID would certainly help and certainly the U.S. Embassies would help in every country where the MCA is operating.

The CHAIRMAN. So you intend to rely upon that structure?

Mr. LARSON. Yes, not necessarily exclusively, but to rely on it very heavily.

The CHAIRMAN. And your staff sets the criteria, tries to gather the data, makes the decision as to who the winners are, and proceeds that way. And that is what the 100 people do?

Mr. LARSON. That is what the 100 people do. And they will make proposals to the board.

We have made clear that because any indicator is imperfect and because you cannot summon an indicator to a hearing to explain why the government is giving money to a particular country, it is important for the board to exercise judgment that can take into account missing or lag data or other factors that may not be captured by that indicator about whether we truly are selecting countries that are governing justly, that are committed to the investment in their own people, and are promoting economic freedom in their own countries.

The CHAIRMAN. Well, the indicators, I think, are great, but they have a highly qualitative content; for example, as you discuss, corruption. First of all, you collect, I suppose, stories of corruption or lack of it. To what extent does this affect American diplomacy? Is it much like the accounts, at least of those who have drug problems? Each year we wrestle with whether they have a high degree of corruption, a low degree, whether there should be waivers. In other words, have you thought through the public relations aspect of listing out the foibles as well the strengths of each of these 74 countries?

Mr. LARSON. Well, I think we have. And we think while there will be difficulties, that there is great merit and openness and transparency. And I know each of us at this table believes that corruption is a cancer that makes development almost impossible.

And both through our initiatives in the international financial institutions, through technical assistance through USAID and through initiatives like the OECD Anti-bribery Convention, we all are trying to push the envelope for greater transparency and greater anti-corruption initiatives.

The CHAIRMAN. Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you. And I welcome our witnesses. Thank you for your appearance this morning. This is an exciting proposal and I compliment the President and all of you for developing it.

And I think there is little question, as the three of you have expressed so well this morning, as has the chairman, the importance of this kind of attention and focus and the resources that must go with it as to the future of our security, if nothing else, American

security, our role in the world. It is an investment in stability and security.

And I think we should see it that way as well as the humanitarian, because it will be those tools—the humanitarian and the economic and the trade and environmental, law enforcement, intelligence that I believe coming together in a seamless network of our allies will do as much to secure the security of this country for the future than our military will. All must be used and will be employed.

So this is very important, what you are doing, and, again, thank you for focusing on this.

Secretary Taylor, describe for me the role of Treasury in here. In your testimony, you have laid out the 16 points but what will be your role here on the board? What expertise do you bring to this effort?

Mr. TAYLOR. Senator, as you know, the Secretary of the Treasury would be a member of the board as currently proposed. And the role of Treasury here, I think, is most important in the focus on the policies that will raise economic growth, and looking at those policies, working with the countries about those policies as we frequently do, whether it is through the international financial institutions or in bilateral ways.

I think another role which is important, which we all share in the government, is measuring the results of the projects—of the specific projects and contributing to that as well.

So it is these economic financial quantitative aspects that I think are so important in this project in which the Treasury has participated in already in developing and helping to develop the indicators, working with other agencies, State, OMB, USAID. So those are the particular things that the Secretary would focus on.

Senator HAGEL. Thank you. I know there is no one here who can speak for OMB, but can anyone explain to me what OMB's role would be? If that is Treasury's role, then what is OMB'S role?

Mr. LARSON. I think there is two things that I would highlight, Senator Hagel. The first is that when fully implemented, this represents a 50 percent increase in the Nation's commitment to development assistance.

And I think the Director of OMB is the place where you have to really look to get advice about whether we are getting the results we want for that substantial investment.

Second, I think OMB, as the agency within the government that really focuses on management and management by objective that the Director would be in a position to support what the Secretary of the Treasury would be doing and helping formulate this measurement of results in making sure that your meeting benchmarks in these programs.

Senator HAGEL. But is that not already the role of OMB? Do you not all have to go to OMB to get your budgets approved, and do you not have to go through that process if there is an appeal?

I mean, I am not sure what new assistance or authority you are adding here. Since they already have that.

Mr. LARSON. In many respects it replicates what is the Budget Review Board right now. And I think that is seen as one of the merits that you have right on the board, the key players that

would be reviewing resource allocation decisions within the administration, if there was a difference of opinion about whether a particular investment or budget allocation should be made.

You have got that represented right on the board of directors.

Senator HAGEL. Administrator Natsios, you wanted to respond.

Mr. NATSIOS. Let me just add one little caveat—not caveat, but sort of an argument here that I do not think is fully understood. There has been a shift in the last 12 years in terms of foreign assistance.

When I left the first Bush administration, most foreign assistance was done through USAID. And in the nineties as the cold war ended, the perception was that most Federal departments should have international programs. Some of them appropriately, some of them, it was a little more difficult to defend, but they have them anyway. And so many Federal departments are involved appropriately in foreign assistance now, and they have technical expertise in it.

If we have this MCA and we do not have a disciplining force on the board that can force other Federal departments over the longer term—this has nothing to do with one administration or another—to have one coherent development strategy, we could have MCA and USAID doing one thing with State and Treasury, and then other Federal departments basically doing whatever they want to, which could contradict what the MCA does.

Senator HAGEL. You are not saying that that is the case now with the Federal programs?

Mr. NATSIOS. No. I am not saying it, but we—

Senator HAGEL. So we should have OMB maybe on all these?

Mr. NATSIOS. No. But I am saying by having them on the board of this MCA, what they are doing is allowing a level of inter-agency discipline.

It used to be OMB that was the disciplinary force during the cold war to ensure there was coherence in strategy. And by being on this new board, I think they are going to be in a much more powerful position to ensure in the future that there is strategic coherence.

Senator HAGEL. Are you aware that OMB was invited to testify and declined to testify? Did the three of you know that? You knew that.

Why would they decline to testify if they will be one of the three board members? Do you have any idea?

Mr. NATSIOS. I do not know.

Senator HAGEL. We will ask them.

Mr. NATSIOS. You will ask them, yes.

Senator HAGEL. Of course, I know you cannot speak for them. But I find it interesting that if they are one of the three board members, they were asked to come up and testify and they declined.

We will ask that—Mr. Chairman, I would like to ask that for the OMB Director, because if they are to play this very important and critical role in protecting the American taxpayer then it seems to me they have an opportunity and some responsibility to come up and explain that, and maybe we can have another hearing for them to come up.

I have other questions, and I will wait till the second round. Thank you very much, gentleman.

The CHAIRMAN. Well, thank you, Senator Hagel.

Senator Chafee.

Senator CHAFEE. Thank you very much, Mr. Chairman.

Senator DeWine and I just got back from Guyana and Haiti over the recess, the recent recess. And we were looking at some of the programs that USAID does have as we look at the funding for HIV and AIDS funding coming up.

And I was very impressed with the work being done in these countries of extreme hopelessness and great challenges. And the reflection that it has on us as Americans to see this American program out there in such hard to travel conditions making a difference makes me wonder what are the frustrations, Mr. Natsios, with the current USAID program, specifically where are the frustrations that caused you to want to make these changes?

Mr. NATSIOS. Thank you, Senator. I am glad you saw two very good programs. I just, in fact, this week met with the President of Guyana, and we discussed the very programs that you saw.

Well, there are several frustrations. One is we have some very experienced people who work in the Foreign Service in USAID who have been career officers for a long time, and who have worked in the developing world all over the world. The level of detail in the appropriation bill each year in terms of what we will spend, where we will spend it—I do not mean in broad categories—is enormous. I mean, you will approve this grant in this country under these circumstances. And it is not a few. It is hundreds of earmarks and requirements. And none of it is malicious. It is very well intentioned, but the effect is to put a huge straitjacket on our people in the field.

I have officers in countries that will say, “We need to spend more money on democracy and governance in this country. That is the critical problem.” And we have no democracy money, because it does not have a constituency in Washington or in the United States that is very clear.

Or another country, a very well governed country, needs help in agriculture; for example, and there is not enough money for agriculture. So the thing the MCA does is to say there are to be no—the President is very clear on this—no earmarks.

The money is going to be programmed within the countries, since they are functioning democracies, using civil society and the parliament and the media and the executive branch. They will make the decisions locally and allocate the resources based on their needs rather than our requirements in terms of sectors and our constituencies in the United States.

So I think that a major problem for us and a major frustration for our officers is the lack of flexibility in the existing structure. This has built up over many, many years. I understand why it exists the way it does, but ultimately the decisions of this kind, I think, should be made in a decentralized way.

Senator CHAFEE. As Senator Lugar said and as Mr. Larson said, this is going to be a very selective program. Does that not concern you that—from my recent experience—the good will that is generated by having these American programs out there and the re-

flection on us as a country at this critical time when we need it most. To pull our parameters in so tightly seems like we are going backward.

Mr. LARSON. If I could comment briefly on that, Senator. We believe it is very, very important for the MCA not to come at the expense of either USAID as an institution or the other programs that you have already mentioned.

For example, the President on HIV/AIDS has called for a dramatic expansion of this over the next 5 years, proposing \$10 billion of new money, most of which would be, I expect, administered through USAID and go to countries based on where this disease is the most serious and where our money is most badly needed.

We are proposing to increase our commitment on things like fighting famine and emergency relief. So we intend to be present in countries where there is a need and where there is an adequate commitment to reform. But we do also believe that this new program, which involves a very, very substantial increase in resources, should be focused in those places where you know you can get the best developmental outcome for every dollar you spend.

And by doing that, we think we can foster greater economic reform. We believe that there will be strong support from the American people and the Congress for these types of initiatives, because they will see the results that we are producing.

Senator CHAFEE. Mr. Natsios, I will also ask in my limited time remaining, your agency will not be on the board, is that correct? And, obviously, the question must be someone that is—an agency that is so experienced in this area, and all the challenges that come with it—we recognize the challenges for trying to make every dollar stretch as far as it can, but all the experience it has to not be on the board is—to me, is perplexing what is the answer?

Mr. NATSIOS. Well, first, I just want to say, we support the legislation as it is written. We have a representative on the board. His name is Colin Powell. He is the Secretary of State. He is my boss. I am at the Deputy Secretary's level. I am not equivalent to the Cabinet Secretary, and that is who are on the board, people of that rank.

So, why have two people from the foreign policy apparatus? We have our representative. He is the Secretary of State on the board.

If I could tell a quick story, though, on the last question? We had the speaker of the parliament of a country—I will not embarrass the country, which has a corruption problem but does well in all the other indicators. He came in and he said, "Well, we want to be eligible for the MCA."

I said, "Well, I am afraid you are not going to be, because there are four pieces of legislation that have been languishing in your parliament for 3 years now that you refuse to pass to clean up this corruption problem. And I am very sorry, but you are probably not going to be eligible."

He did not say anything. I asked our Mission Director yesterday what effect did that have. He said it has caused convulsions in the capital.

They went to see the President. They said, "you know, we could not be eligible for this just because we did not get this legislation

through and we are not implementing it. And that is a lot of money that we are going to lose.”

So they are actually now for the first time in 3 years taking this seriously. Because it is such a large amount of money and the incentive is so big, it is changing countries that might not be eligible. That helps us in the existing USAID program in a country, because our biggest impediment to doing development in that country is the corruption problem. And they are now facing it, because they realize it has done damage to them for their eligibility.

Senator CHAFFEE. It appears the parameters are still tight for that. Thank you.

The CHAIRMAN. Thank you very much, Senator Chafee.

Senator Brownback.

Senator BROWNBACK. Thank you, Mr. Chairman.

Gentlemen, thank you for coming here and, Mr. Chairman, thank you for holding the hearing.

I want to compliment the administration on this Millennium Challenge Account and Millennium Challenge Corporation.

With Senator Moynihan, we were talking about an issue that both of us were trying to grapple with. And he noted in all his experience here that until you figure out how to measure something, you can rarely figure out how to change it. And that seems to me to be really square-on with what we have in our history of development aid funding and where we are today.

We have done a lot of development aid funding, and we have done it out of—really trying to think we are doing things out of the goodness of our heart, it is the right thing to do. We want to help people. Those are the right instincts, the right way to go at it. But we need to continue to figure out how to measure it, or you rarely are going to be able to figure out if we have really been successful with this or not.

Consequently when you go across the country, a lot of people are not very supportive of development aid funding. They think it is a much larger portion of the budget than it is.

I generally have people say, when I ask a group, “How big do you think the developmental funding aid is, foreign aid?” generally “Around 25 percent” is the usual figure that I get.

And when I say 1 percent, then I have lost credibility with the audience, because they do not think that can be true, that it is at that level.

But I think a big portion of it is they are good-hearted people. They want to support and do things right to help others, but they just—the history has been very checkered of success and failure and how it has been given to people. And on what basis has it been passed to others? Is it based on some sort of political relationship between the President of that country and the President of this country, and that kind of thing. Is there some greater issue that is involved and the money is wasted? And there is a view of a strong amount of waste.

That is why I really compliment you on this program. It is measurable. It is definable. And it bases it on accomplishments that are there and not on any sort of basic political relationship.

The premise I would hope you would look at this in the future that, if we get this established, as pouring other funds into it. And

I think, Mr. Natsios, you were suggesting that we have got a lot of different agencies that have international funds now. I would hope that more funds could be attracted to this sort of criteria-based allocation. And not all and each country is in a different setting than what—than another one is, and I would like a group discussion too.

I worked in Central Asia for some period of time, and clearly that region needs to work together and collectively to expand its economic opportunities, expand its trade, expand the east/west corridor, oil movement. And there are huge synergies for them if we can encourage them to work together.

But I would urge you—and I do not know if there is any thoughts about this, about drawing more of the foreign aid budget into this sort of criteria based allocation rather than just starting a new account and it being another foreign aid account, rather than one that really helps reform the system or—I do not know if anybody would care to—

Mr. NATSIOS. Let me just speak about our budget in USAID. We are actually going through a very substantial review of the way in which we do our business to use the MCA model and criteria as a way of restructuring USAID internally.

And if you look at the longer testimony for the record, it goes into some detail as to how we are doing that. We have done a lot of work on it, and I have to say there is wide acceptance within the agency that this is the opportunity to change what we know does not work for a model that career people and others are very enthusiastic about.

We believe the President was right on in what he said; and not just because he is our boss, but because based on the empirical research, which is initially what it was based on, he is exactly correct.

So we are looking at the existing portfolio in a detailed way in determining which countries fall in which category. A failed or failing State like Sudan or Somalia, which has not had a government in 10 years, for example, is not going to be eligible for MCA, and we cannot provide assistance to them based on this model.

We are not going to provide assistance to HIV/AIDS based on whether the government reforms or not because it is an epidemic that crosses national boundaries. So there are nuances in this that we need to make sure get worked into the language we structure in the existing program.

Your point is very well taken. You are exactly correct and we are trying to do that now.

Mr. TAYLOR. Senator, I just want to add to that with respect to the foreign aid that goes to the international financial institutions, for example, the World Bank's funding for the poorest country item, we are also trying to emphasize the same features in those programs as well.

For example, the most recent replenishment item has a very specific measurable results component to it. And in the authorization we are requesting, there will be an incentive built into the World Bank to explicitly measure the accomplishments of their programs in much the same way that we are focusing here in the Millennium

Challenge Account. And there is also an emphasis on allocating the funds based on policy performance.

So in some sense the MCA is incorporating the features that are so important and the President has emphasized, but we are trying to have those same features apply to other parts of our foreign aid as well.

Senator BROWNBACK. Good. Good.

Mr. Chairman, I would just note that, finally, on this that we generally have done many things in our involvement based upon vital and strategic interests of the United States. And I think that measure has generally served us well.

But I think in looking to the future, vital and strategic is going to include more functions with it, and this is one of the functions of expanding democracy, of getting systems right. Systems of government really matter. Just compare North and South Korea if you want to get a real drastic example of that. One is the 12th largest economy in the world; and in the other, a third of its people are living on food aid donations. The systems hugely matter in the world.

I would hope that as we move forward, the overarching views for foreign policy that are not vital and strategic, we look at how we do our compassion and how we present that in a way that can be most empowering to the people. And that is why this account in the way it measures and is set up is really good.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Brownback.

Normally, I would recognize a Senator from the other side of the aisle. But I am going to ask permission of Senator Feingold, if I may, if I could recognize Senator Sununu who has been here for a portion of the hearing, and then I will recognize the Senator from Wisconsin.

Senator Sununu.

Senator SUNUNU. Thank you very much, Mr. Chairman.

There has been a little bit of discussion today and in terms of the materials we have had about the cases, and the role of the four, and trying to differentiate between those cases.

I am a little bit concerned. Maybe I am looking too far out. But I am a little bit concerned about a problem that may arise, and that is whether or not you fund all of the countries that may be eligible. And it is certainly the possibility—and I would suggest the hope—that we might have 60, 70, 80, 90 countries available if you look at the different income determinants, those that will be eligible. And certainly over 100 countries are potentially eligible as the program is now structured.

My question is whether your goal is to get off a good system that can choose among qualified countries, or if the goal is ultimately in the near term to fund any country that qualifies. Mr. Larson.

Mr. LARSON. First of all, we do think, at the very beginning, Senator, this is going to be very selective. And we expect that the number of countries that we will prove to have been above average in the, you know, in at least half of these various indicators will be a relatively small number. But even then, we—

Senator SUNUNU. I am sorry. I have got to interrupt you. This may sound a little bit picky, but my guess is that, again, the pool is around 115 countries. Roughly one-half will be above average.

Mr. LARSON. Well—

Senator SUNUNU. And so I do not have—I do not think that should be the metric within the pool of selecting those countries that are above average in the pool. I do not think that is what you meant. I do—

Mr. LARSON. I do not, but—

Senator SUNUNU. I will give you a chance to be clear.

Mr. LARSON. No. What I want—when Mr. Taylor outlined this, he said you would have to be above average in a number of different areas.

Senator SUNUNU. Right, but—

Mr. LARSON. By the time you do that, you start winnowing out countries because they may be doing fairly well in one segment, but then they fall down in others. So that is how the selectivity tends to operate.

But even then, we do not believe getting into the eligible pool makes this an entitlement. Countries have to come forward with proposals that reflect their development goals and aspirations. But they also have to be proposals that we believe in and are credible, because we are their partners and we are putting our tax dollars to work there.

As this program continues, we do believe also that countries that are participating with us as partners should do so with the expectation that we are supporting a specific activity that does have a beginning and an end. We want these projects or activities to be sustainable after a few years of U.S. support, because we are not thinking about having an indefinitely long funding relationship for a particular activity in a particular country.

We want to emphasize the idea of self-reliance, having this be a kick start, but not something that just continues year after year with the same country, the same activity.

Thank you.

Senator SUNUNU. There seems to be a slight contradiction here, which is to say that you are setting up a challenge account where you say, “If you meet specific criteria in 16 different categories, you become eligible for support.” And by structuring a program with such incentives, then you should be encouraging everyone that is eligible to do certain things.

But then you are also saying another hurdle, once they become eligible—you were talking about project-specific assistance once they become eligible. Does not the existence of that additional hurdle in some ways discourage countries from—or reduce the incentive for countries to meet all of these criteria if the possibility is there that even having met all the criteria, they are not going to receive any benefit from it?

Mr. LARSON. I do not think so in practice, for a couple of reasons. First of all, the amount of money that potentially is available is very fine. Second, we are prepared to work with these countries to develop activities and proposals that are consistent with their developing priorities, but also are ones that we believe are credible, that have the built-in benchmarks that we talked about and that

we believe that the Secretary of State and the board can come before you and say, "We believe this is a good use of taxpayer money."

We think this sort of posture, vis-a-vis our partners, will mean that there will be good activities that promote their development and that the board and that you will support.

Senator SUNUNU. It seems that that, in the end, is an affirmative answer to the question, "Are we going to differentiate among countries that meet all of the requirements?" Is that correct? So you envision even if there are multiple, 60, 70, 80 countries, 100 countries that meet the requirements, the goal is still to pick and choose among them based on the strength of programs or how they—

Mr. LARSON. If we have that many countries that qualify, we already will have had very significant success in promoting the sort of policy reforms that will help countries develop at their own speed. But, yes, I think the board—I know that Secretary Powell believes that the accountability aspects of this are very important. He believes he will be accountable to the President, accountable to the committee, accountable to the Congress for how these resources are used.

And so it has to be for projects that we—and activities that we think will produce the sort of results the American people expect. We think we will have gotten off to a very good start by ensuring that in the first instance we are working with countries that have crossed these policy hurdles and have shown that they are committed to good economic policy. But that is not the end of the process.

Senator SUNUNU. At what point are countries no longer eligible for assistance? Are you just going to—is there a per capita income window for the middle income countries? Do you just hold that per capita income level and when a country gets, you know, \$2,500 per year per capita, they are no longer eligible?

Mr. LARSON. We certainly see the per capita income level as something that would graduate a country from eligibility. We also intend to support a specific activity that is proposed by the country and agreed by us, and perhaps lasts for a couple of years. When that activity has been successfully completed, they would be graduated from that activity.

Now, they may come back with a very good suggestion about something in another field. And if it is a good proposal and their track record was good on the first activity and they are still eligible to participate in the program, that is something we could consider.

Senator SUNUNU. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Sununu.

I have consulted with the senior ranking member, and he has asked to continue with our plan to recognize Senator Feingold, which I will do. Then I will recognize the senior ranking member, and then Senator Alexander.

Senator Feingold.

Senator FEINGOLD. I thank the chairman and ranking member very much.

Let me just thank you and followup a bit on what Senator Sununu was just discussing. Have you actually done a test run

with these indices that you discussed? What was the turnout? What were the results?

Mr. LARSON. We have done a number of test runs during the last year of review. And we are continuing to get better data and more updated data. And I think we will, if and when the Congress approves this approach, we will do a run or a competition based on the latest data that we have.

But the illustrative results that we have produced have suggested exactly what the chairman said at the beginning, that it tends to produce a group of roughly a dozen, could be a few more, could be a few less, countries that meet the indicators. That, of course, does not take into account the operation and the function of the board to make a responsible judgment about whether the indicators are really telling the whole story.

Senator FEINGOLD. Is there a way to get more specific preliminary results from this, that our committee could get so we could get a sense of what problems there may be? You are asking us to authorize this, and I am wondering if we could get a little more information about those, and about what you have come up with so far, subsequently.

Mr. LARSON. I think we will be prepared to work very intensively with the committee, Senator. Just to show you how these indicators work to—I mean, one of the things that is notable about this is that it is the most transparent process for considering foreign assistance allocation that I have been familiar with.

We have outlined the indicators. They are available on the Web. They are publicly available, and so there is no problem in getting a very good sense about what we are looking at. And we will be prepared to intensify that discussion with you subsequently.

Senator FEINGOLD. All right. We will followup with you on that.

The draft MCA legislation proposed by this administration does not spell out eligibility criteria in detail. And I do respect the need for flexibility, especially in a new initiative.

But if we are going to commit taxpayer's dollars to this program, I am a little concerned about the potential rejiggering of criteria down the road to improve the eligibility of, let us say, a political favorite or shut out a good performer that might, let us say, differ on a vote with the United States on a controversial matter before the Security Council—

Senator FEINGOLD. Is it not possible to get a little more specific in a legislative format with regard to these criteria and still meet the administration's need for flexibility and enforceability and that kind of thing as was suggested?

Mr. LARSON. I think we have to strike a very thoughtful balance on this issue. We have done something that I believe is unprecedented in spelling out the amount of detail we have, the sort of indicators that we think ought to inform the judgment of the board.

We have also said not only are those indicators publicly available, but that the decisions of the board will be publicly available. And the contracts that our government signs with another government will be publicly available. So the degree of transparency that we are envisioning in this program is something that is absolutely unprecedented.

At the same time, none of us—or each of us, with the first two, admit that these indicators or any indicators are imperfect in certain respects. In some cases, there is not data available for all countries. In some cases, they do not capture everything you want to know about good governance or about investing in people or about the entrepreneurial climate that countries have or do not have.

And for that reason, I know that the Secretary of State believes, while respecting the developmental goals of this program and feeling very strongly that this is a developmental program and not a program to accomplish other national objectives, that he and the board have to be accountable for the decisions that we make about where this money goes, and that they cannot say, “Well, we do not think actually country *x* was such a good investment,” but the indicators pop them up into the group. The Secretary is very, very clear on this. He wants us to be developmental. He wants the process to be informed by the indicators, but he also believes that he is accountable to you, not the indicators.

Senator FEINGOLD. All right. I hope we can work together and consider the possibilities and legislative language that would clarify these criteria and, at the same time, not destroy the needed flexibility. And I hope we can work together on that.

Would you tell me a bit more about the graduation concept associated with the MCA? Is it just a function of the length of the contract, or is it linked to some objective set of indicators?

Mr. LARSON. Very briefly, we believe that an eligible country would come to us and say, for example, “We think that our biggest developmental challenge is—the thing that will get us over the hump is”—let us say it is primary school education. And we know that the United States is not going to fund primary school education in that country for the long term, but we need to develop with them a specific set of initiatives. Let us say it is teacher training, textbook and curriculum development, and a certain set of very specific activities that they think over a period of 3 or 4 years will help them reach a new threshold of activity.

We would want to build into that project the benchmarks that show whether they were on track and the sustainability assessment that shows that if a project is successful over, say, 4 years that they can carry it forward from then on in, and they would have graduated from that project.

As I said in response to Senator Sununu’s questions, that does not necessarily mean that they could not come back if they were otherwise still eligible and say, “OK. We have a very important set of developmental objectives in the area of agriculture, and we would like to see if we could develop a similar project there.” We do not rule followup contracts in. We do not rule them out.

Senator FEINGOLD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Feingold.

Senator Biden.

Senator BIDEN. Thank you very much. My absence was not for lack of interest. Secretary Ridge and Attorney General Ashcroft and the Director of the FBI are before my other committee downstairs. So I apologize, Mr. Chairman, for being late.

I wanted to followup on the question that Senator Feingold asked about the test runs. It would seem to me that that would be a fairly significant indices of how this is likely to work. My staff informs me that—in my request to them, they—and they then have asked about this, what some of these results are. I am not particularly looking for, you know, the names of countries who have crossed the threshold.

I want to get a sense from you all of whether or not there is reason to believe that as we move in this direction in light of the fact that we talked about in this committee, in the previous several years under the former chairman, of reorganizing this whole account, if you will, under the aegis of 8,000 people in the Ministering and Aid Center, and this massive reorganization, which we—massive, or significant reorganization of the State Department.

So can you give us some more insight without telling us what, you know—which countries cross the threshold? I mean, what should we, who are trying to support what you are talking about here—I mean, I do not think any of us disagree that study after study for the past 15 to 20 years shows that our aid is—its efficacy is in direct proportion to the fertile ground upon which it falls, whether or not it is used for social purposes, whether there is an infrastructure to distribute and so on and so forth. We all agree on that, and so we are on the same page.

And Mr. Natsios knows a lot about this. He has been one of the people who have talked about this in the past prior to this present incarnation and this present responsibility. But it seems to me that the very committee you are asking for the reauthorization or the authorization to move in this direction should get some sense of what you are—of what the runs have indicated. What do you anticipate?

This is not a, you know, you get a “Get Out of Jail Free” card in this room. I mean, if it does not turn out exactly like you think, that is OK; we understand. But can you give us a greater sense of what, if you were a betting man, based on the runs, what you—what we would look forward to in terms of countries that would be able to be recipients that would be able to, once this is up and running, that would have the more efficacious use of our limited resources?

Mr. LARSON. Thank you, Senator. I appreciate the way that you phrased your question because we, frankly, have been concerned that if the administration started publishing lists at this stage, at a point when we do not have what will be the latest data, we are going to start raising expectations, perhaps, for countries that are—

Senator BIDEN. And I would suggest, Mr. Chairman, that maybe you consider—I would propose for your consideration that this study and list be submitted to us in a classified forum. It does not have to be in this public forum. But It would be helpful to us.

But in an open forum, if you could give us some sense of—I have actually made that request, if you would consider that, that you would give us that and we treat it as classified.

And it is not because it is a national security secret, but it is, practically speaking, a little bit like why all of the time that we

have worked on, for example, the expansion of NATO, it is not a good thing to put out the list that we are looking into, because it creates expectations, and if expectations are not met then there are consequences.

But at any rate, can you describe in a more generic form the percentage prospects that you think the nations will—

Mr. LARSON. Well, yes, sir. And very briefly, what tends to happen is that you get a group of roughly ten to a dozen countries. Obviously, by definition, all are very poor countries with per capita incomes under \$1,440 or so. Some are African countries, and some are in this hemisphere.

And by definition, they are all countries that have shown themselves to be performing relatively well under these indicators in the areas of government, social investment and their own economic policy framework.

Senator BIDEN. So the bottom line is you think that there are enough potential recipients that our assistance will have some impact that goes beyond arguably a suitable country. In other words, this notion that—I assume one of our objectives here is to promote—again, if I can make an analogy to a military alliance, one of the greatest things for the expansion of NATO in my view was the so-called Parry principle, which required nations to settle non-military issues in order to qualify.

I would respectfully suggest that the Hungarians would have never worked out their differences with the—or I suggest that Poland would have never really worked out its border disputes. I suspect that a lot of things would not have occurred were it not for the carrot out there of NATO and the realization that you had to meet this requirement in order to be eligible for consideration.

So I assume one of our purposes here is not only to identify nations that would qualify now, but that when other nations realize that what they need to qualify, that it requires them to have a system that is more consistent with the principles that we are laying down here, that this will grow. Our goal is for the number of recipient nations to grow, not to diminish, correct? I mean, I assume we are all on the same page.

Mr. LARSON. Well, you are correct both in your analysis and—you are correct in the assumption that we would like to see this number grow, and you are also correct in suggesting that even now each of us are seeing very dramatic evidence that countries are looking at their policies with exactly the same results that you hope for, that “We better do a better job on governance or some other issue if we hope to qualify for this program.”

Senator BIDEN. Well, I wish you luck. I have a question that I would like to submit in writing so I do not trespass into Senator Alexander’s time, about why integrating within the existing structure does not work. I mean, we have got—you know, we went through this reorganization. And why is the administration suggesting we establish a new aid organization? Why not within the existing administration? And as we work through that, the question remains. And you talked a little bit about are you going to have call on some of the 8,000 folks in USAID to accommodate the ability to function. That will be useful for me to know.

The CHAIRMAN. If you would respond to that question—

Senator BIDEN. I will submit it to you in writing. I would appreciate it.

The CHAIRMAN. I join the Senator from Delaware in asking for a classified or unclassified estimate of countries eligible. However, I would mention that in our second panel, Mr. Radelet has already listed 13 countries and published that in the Washington Quarterly, spring of 2003 issue.

So we will get another point of view, or maybe the same one.

Mr. TAYLOR. May I say something briefly about this?

The CHAIRMAN. Yes.

Mr. TAYLOR. I think one of the real nice things about this or the way this is constructed is these indices are publicly available. So if Senator Biden and his staff would just look at what the ranking is and the index on civil liberties or the heritage index for free trade, you will see right away what countries are close to meeting these. It is very transparent, and that is why it is so easy to replicate, as many people in the private sector are beginning to do. That is a feature.

But there will be missing data. There will be revisions to data. And that is why the judgment ultimately is required. And any one list at this point could be potentially misleading.

The CHAIRMAN. We will ask staff to go to the Web sites and begin to cull out this information for us.

Senator Alexander.

Senator ALEXANDER. Thank you, Mr. Chairman.

I am all for this Millennium Account idea, and I have some thoughts about it, and I have a question about it that I would like to ask. And I hope I did not miss this when I was somewhere else earlier, so please tell me if I did.

I like the idea of awarding countries who are working hard to improve their incomes and expand their freedoms. And I think human nature is such that if you do it with a few people and you have a lot of flexibility in how you go about it, that you might learn something and you actually might succeed in doing it.

I also think it is much easier for the American taxpayers to understand foreign aid. It has always been said that it is a constituent of one, the President. And so I think it is easier for taxpayers to understand in these countries, that creating jobs and expanding freedoms, that that is worth rewarding.

As I look over the criteria, I think back on the economic development and the things that I have been involved in as a Governor. And it is not so different in other countries. They are starting with less freedoms, but when I became Governor, we were 70, 80 percent of the national average income and we wanted to get up to 100.

There were a lot of things we did. But as I look back on it, what helped cities in our State and our State more than anything else was first identifying something that was unique to our State, something, some strength that we had.

Much more than any kind of indicator of how much you are spending on health, how much you are spending on this, or whether you have civil liberties, or—all those things are important and are indicators, but how does Memphis get from where it is to where it goes? Well, it first remembers that it is on a river, and it remem-

bers that its agriculture is important and not to be embarrassed about. And then it remembers that it has a central location, which is why Federal Express is there. And it has the Peabody Hotel where ducks walk across the—you know, every day at regular hours in the parlor, and people come to see it.

And they celebrate those strengths. And the people of east Tennessee celebrate their Appalachian culture, and Nashville celebrates Music City.

So I am wondering if as—my inclination would be for you to be as flexible as possible. I would take the risk of failing, and I would take the risk that one administration might do something that another one would not.

I mean, who is to say that there is not a little bit of rewarding going on today as we look around the country and at the Security Council with our present policy? So that is going to happen.

So let me take a specific example. Let us take Gabon in Africa. There they set aside 12 percent of their land for national parks. That would be celebrating something that is unique and special about a country that is poor and has not got so many institutions that would help it expand its freedoms and grow its incomes. Would a strategy that is based on starting with creating 12 percent of your land in national parks and letting other institutions and other improvements come from there, would that fit within the kind of criteria that you are considering for grants from the Millennium account?

Mr. LARSON. Yes. I think you are focusing in on a very important issue of what do we actually do with this money once a country is eligible. We have put a lot of emphasis on these criteria and indicators for getting into the program; but once a country is in the program, then it becomes exactly the sort of process you highlighted of identifying the comparative advantage, identifying the one big push that can really take them to the next level.

I mean, to take—and what the President has made clear is that we want to be able to be involved in any project that is a growth generator or a productivity driver. We have given some examples—agriculture, health education, trade, small business expansion, but—

Senator ALEXANDER. But what about conservation?

Mr. LARSON. But a national park—I mean, if this—you gave the example, Senator, of Gabon. I mean, let us suppose that they felt that ecotourism was a real driver of economic growth—

Senator ALEXANDER. Yes.

Mr. LARSON [continuing]. They could expect to bring lots of people in, generate jobs for their people. That would be something that one could look at.

But what the goal is to achieve growth, because growth will generate the resources if properly used to bring people along.

Senator ALEXANDER. Right. Right. But I am suggesting that even before you get to the business of creating growth, that in the case of Gabon—and I am not even sure this is true or not true, I am just trying to get it down to specifics—that before you get to results, even—or programs, you need a sense of confidence, a sense of spirit—I mean, a community needs to come together for some

reason and say, "Hey, we have got something here. Let us work together to go forward."

And in one place it might be oil. In another place, it might be a national park. In another place, it might be a devotion to education. In another place, it might be the location of—the weather. It might completely depend, but it would be a coalescing spirit that causes the country to actually want to work together and then you can get to all these other things. And it would seem to me you would not want to jump over that if you are really—it is like a nurturing a child and helping to what identify the strength of that child is.

Mr. LARSON. We put great emphasis in our description of how we imagine this program working. The process of citizen participation, the coalescing of the society around development goals.

We have made clear that we believe one of the responsibilities of a partner country would be to have that sort of process so that any development priority was not the development priority only of the President or only of the Finance Minister, but it was the priority of the country.

So we do see this idea of citizen involvement, involvement of civil society and coalition and coalescence being very important to the idea.

Senator ALEXANDER. My last comment, and I would not want to push the analogy too far, but I remember in the case of both Memphis and Chattanooga when they were beginning processes 20 years ago to try to move their cities, which they have done a magnificent job of, in our initial discussions I actually asked them to go back home and create much larger broad-based groups of people and go through a broad-base process, all of which sounds very mushy, to try to set up some goals.

And in Memphis, there were 2000 people who did that, in Chattanooga there were several hundred. And out of that actually came specific objectives, a sense of ownership and there may be some usefulness in that metaphor.

The CHAIRMAN. Thank you very much, Senator Alexander. Let me ask if there are other questions from Senators that you would wish to ask of this panel?

Senator HAGEL. I have one.

The CHAIRMAN. Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you. I had just one. You all are well versed in the Foreign Assistance Act of 1961, which I have portions of that law in front of me, Public Law 87-195.

And as I have read it again—my staff gave it to me yesterday—almost everything that you are talking about accomplishing, focusing on in this Millennium project is covered already under public law. The criteria, they spell it out: transparency, freedom, women's rights, and so on. It is all here. I assume you have seen it all.

So I assume—I suspected as most Americans—that we are already doing this as we focus on foreign affairs and where our foreign aid goes and on what basis that foreign aid is allocated. So it is already here. It has been around for a long time, so I assume USAID is already following this, so I have not heard anything new here today that already is not in law.

Now, the question is—two questions really, is USAID not capable of administering a program like this? Why would we set up a new program? Why would we set up a new bureaucracy? Why would we set up a new structure?

And then the second part of that, which I ask tangentially, be—but we could not answer because OMB preferred not to come up here: Is it standard practice for OMB to participate on a board that actually sets policy, that actually participates in implementing policy that this board obviously would do, since OMB is already the court of last resort when it comes to money and budgets and management as far as I know. And I think they guard that rather well, and they should.

So I know you cannot answer for OMB, but anything you can tell me about that, and then really, but my major question is to why is USAID not capable of doing this, since everything you are already talking about is in law now. This is not a revolutionary thought as to why we grant our foreign aid assistance the way we do.

Mr. Natsios, you may begin. Thank you.

Mr. NATSIOS. Foreign aid serves many purposes. One purpose is humanitarian assistance regardless of the national government, regardless of reform to people who are in the middle of a famine or a civil war or an epidemic or that have very high rates of child mortality, for example.

You know, Afghanistan had the worst human misery index in the world prior to September 11. And our assistance to those countries is not based on the performance of the government. Indeed, in many of the cases, there are no governments.

Somalia has not had a government in 10 years. The Taliban was not really a government in a formal sense. And there are those countries that are not going to be covered by the MCA. USAID, however, spends \$2 billion a year in dealing with those failed and failing States.

There are another set of countries that are critically important geo-strategically for the United States. I have to tell you I know which countries they are—I do not want to embarrass countries, but, you know, our program there is for political and diplomatic reasons. Appropriately, you can guess what they are. We have added a few countries to the list in the last year just since the terrorist wars started. This legislation is not directed to those countries.

Some programs we run are regional in nature. They are not country specific, because the programs like some of the great river systems in Latin America or Africa, require regional approaches. They are not country specific, and they require us to set up regional governance structures. MCA does not deal with that. OK.

Our development assistance account is actually a relatively small part. This year, it is about \$1.3 billion of the \$10 billion we spend. Only \$1.3 is really in the area that you are talking about. So it is a relatively small portion.

What the President is proposing here is a massive increase in that portion that should be based on criteria. And I think the difference between the Foreign Assistance Act and this legislation is that the Foreign Assistance Act does not say that the allocation of

resources will be based on past performance. That is a profound shift not only in the United States but in international institutions and in other donor governments.

That is not how we are allocating aid now. And the difference is, for 20 years now, we have been focusing on what is called conditionality. We will give you this money, this additional aid, if you will do these things that are good things to do in terms of policy in the future.

Well, it has not worked very well, because half of the time the countries never do the things that they say—because there is no local commitment as Senator Alexander properly pointed out. Unless there is local commitment, it does not work very well.

So what this is saying, this is creating some competition. Some of the countries actually told me they resent this. And I said, “Well, I am very sorry if you resent it.”

They say, “Well, we are not going to be eligible for this.”

I said, “There is a reason for it. You are not doing the things needed to make your country progress.” We are going to give money and distinguish the countries that really are performing. And most of us know what those things are.

That is not how aid is distributed now. There are other criteria that we use in a variety of areas.

Senator HAGEL. So USAID could not do that. That is why we require a new bureaucracy, to do this.

Mr. NATSIOS. Well, it is not a new bureaucracy. Let me—

Senator HAGEL. It is not new?

Mr. NATSIOS. No. In the sense that there is only—

Senator HAGEL. Oh, according to what you have given me here, 100 new staff people—

Mr. NATSIOS [continuing]. 100 people—

Senator HAGEL [continuing]. And we are going to confirm a new director.

Mr. NATSIOS. It is a coordinating office in Washington. A hundred people cannot spend \$5 billion, I do not think. Our testimony is that other U.S. Government agencies that do work in the field, including USAID will, in fact, be managing portions of this in the field.

And the President does not want parallel structures.

Senator HAGEL. My question is: USAID is not capable of doing that now?

Mr. NATSIOS. I think we do a good job, but we have many different demands on us right now. And this account is trying to separate out, funds to reward performance. The problem we have is we have many, many demands on our existing program that are not based on performance.

Senator HAGEL. Thank you, Mr. Chairman. May Secretary Larson respond? Thank you.

Mr. LARSON. I wanted to just add three quick points.

First of all, USAID enjoys great confidence in the administration, and they are being asked to do many, many more tasks, even in the President’s proposed budget.

Second, it has been commented earlier in the hearing that foreign assistance has a constituency of one, that the American people

do not understand the relatively small amount of money that is going to it and they are not sure they are getting the results.

One of the things that I believe the President feels strongly is that in asking the Congress and through the Congress the American people for what amounts to a 50 percent increase, it is very important to show that we are doing some things differently with this program and that one of the things we are doing, and this is the last point is that in this program, we are focused very tightly on developmental outcomes. We are focusing on a select group of countries that are committed to reform. And we are doing the whole process in the most transparent way that we have ever done before, and the American people can see what is—how decisions are being made with these incremental resources.

Senator HAGEL. Thank you. Mr. Chairman, thank you.

The CHAIRMAN. Thank you very much, Senator Hagel.

Senator Chafee, do you have further questions of the panel?

Senator CHAFEE. I know the second panel is coming up. I do have one quick one. Mr. Larson, did you say that—I think I heard you right that the board will be able to make some decisions themselves as to the allocation of the money. The board is really going to have a lot of power.

Mr. LARSON. Yes. The board has a number of responsibilities that are set out in the authorization, setting policy and setting the framework, but also including making final decisions about selection of countries.

And we believe—I know the Secretary of State believes that it is important that at the end of the process that there is Cabinet level accountability to the President and to the Congress and to the American people about the decisions that are making, who is in this program, and how the money is being used.

The Secretary has made very clear to me that in his view this does not mean injecting non-developmental considerations into the process, but it does mean being sure that we are—have confidence that the indicators and the other sources of information that we use to help us form a judgment about whether a country meets the President's criteria, you know, there needs to be a review of that.

It could be just a case of data—I mean, I will give you an absurd example, a country might look very good on the basis of the criteria; but last month there was a military coup, they abolished human rights, and they adopted backward looking economic policies.

You know, you would not expect—and no one would expect that the board would nevertheless approve MCA eligibility for that country. That is an extreme example, but it is, nevertheless, an example of an area where we believe and the Secretary believes that there is an element of judgment, that this board like any board should be expected to exercise. They are going to do it in a very transparent way, so that you and the American people will see.

Senator CHAFEE. Now, just to followup, I think what Senator Hagel was driving at is that the program is essentially targeted for the people, and sometimes the people do not agree with what their government is doing. And I think that is where we have our questions. Let me go to the second panel.

Mr. LARSON. Yes. Well, and, again, sir, we are very sensitive to the issue that some people have the misfortune to live under very bad government. And that is why we have humanitarian programs. That is why we try in some of those places to work through non-governmental organizations to provide certain types of services.

But we do believe that when it comes to getting the biggest developmental impact out of our dollars that we need to be working in countries that are governed justly, and that do have a good economic framework, and are making investments in their own people. And so for this program, for this program, we want to make sure that we are concentrating on those types of situations.

The CHAIRMAN. Thank you, Senator Chafee. We thank the panel.

Let me just say for the record we have the draft legislation that you have proposed and likewise it has been received by the House International Relations Committee.

And we have had consultations with them. They want to act quickly and we do too. I would say that each one of us on this committee will try to become more familiar with the criteria. We have had a number of questions about that today, about how USAID will interact, about Mr. Natsios's work there. He commented to the staff and likewise to the Senators that is important to consider.

We want to try to think through with the U.N. formally and with others from the non-governmental organization community how their efforts in these countries will either interact or impact, or how the governments that are involved will deal with all the requirements for data or for concepts that are a part of this, and are an important part.

And those will be considerations as we try to take a look at the language that has been presented to us. We may make some revisions or suggestions as we proceed.

And we thank you all for a very constructive piece that helped each one of us today. We have had good participation, and we look now to the next panel.

The Chair would like to call now Dr. Steven Radelet, senior fellow of the Center for Global Development; Ms. Mary E. McClymont, president and CEO, Interaction, Washington, DC; and Ms. Susan Berresford, president, Ford Foundation of Washington, DC. Thank you.

Thank you, Secretary. Thanks so much for coming over.

[Brief recess.]

The CHAIRMAN. If we could reassemble now and obtain order in the committee room, the Chair would appreciate it, because we want to proceed with the distinguished panel. I have introduced you, and I will ask you to testify in the order I introduced you.

Understand, please, that your full statements will be made a part of the record, and we will ask you to summarize appropriately.

Dr. Radelet.

**STATEMENT OF DR. STEVEN RADELET, SENIOR FELLOW,
CENTER FOR GLOBAL DEVELOPMENT, WASHINGTON, DC**

Dr. RADELET. Thank you. Thank you for the opportunity to testify on this very important issue. I think overall the Millennium Challenge Account is a program that is worthy of our support. It could be one of the most important changes in U.S. foreign assist-

ance policy in many decades. With modifications, however, I think it could be even better.

U.S. foreign assistance, in my view, stands at an important crossroads. If the Millennium Challenge Account is implemented well, with strong design, sufficient staffing, particularly on the ground, and if it is well coordinated with other programs, it could significantly improve U.S. foreign assistance, not only within itself, but other programs as well.

However, if it is not done carefully and the Millennium Challenge Account fails, it could set back support for other foreign assistance programs at great cost to our security, our humanitarian goals, and other foreign policy goals.

There are several strengths to this program. First, its focus on poverty and growth will help clarify the mission of the organization. It concentrates on countries with committed governments, which will ensure results, stronger results. It calls for strong recipient country participation, which should help set clear priorities and also strengthen results. And it's very transparent, both in the selection process, also in the proposal design, and in the proposed evaluation process. All of these strengths are worthy of keeping.

I should mention that the greater recipient involvement goes hand in hand with selectivity. There was a lot of talk this morning about the small number of countries that might qualify for this. That goes hand in hand with the opportunity to provide those countries with much more say in how these funds would be used.

The more we expand the program, I think the less—into less responsible governments, the less able we are to involve those governments in setting priorities and giving them more flexibility and responsibility.

There are four key issues in my view to making sure this program works well. One is the country selection process. As you have already mentioned, using the administration's criteria, I have gone ahead and constructed a list of countries.

There was talk about your staff getting the indicators off the Web site. There is no need. You can just ask me. I have all of them already. I would be happy to share them with you.

Now, this is my list. It is not the administration's list. They are right. The data will change. I have talked to my friends at the World Bank Institute. They create five of the sixteen indicators. In 2 weeks time, they are going to change—they will update those indicators, so this list will change. And I think there is good reasons why the administration has not gone public with the list.

But according to the data that are available today, there are 13 countries that would qualify in the first year.

In the second year, only 11 countries would qualify, as the pool of countries expands, the medians rise, and fewer countries meet the standards.

In the third year, in addition to those that are already qualified, a new group of countries become eligible. Four additional countries would qualify by these standards.

I should note that my list has already changed in the last 2 months as new data has become available. My updated list is part of my testimony and the list will change.

My biggest concern about the selection process is the addition of the third group of countries in year three with incomes between \$1,435 and \$2,975. In my judgment, these countries should be omitted. Their needs are much—although there is poverty in these countries, their needs are much less acute than in the poorer countries. They have much greater access to private sector financing and so less need for aid. And third of all, it could politicize the process because, as you mentioned earlier, Egypt, Colombia, Jordan, Turkey, and Russia are in the group of qualified—or of eligible countries.

The second issue that should be considered to improve this is the median scores. Using—I think they should use absolute scores rather than medians. There is a particular problem with using median scores.

As we encourage other countries to improve their scoring, the medians go up. And so countries that once qualified will not qualify as other countries improve their standing. We need absolute standards that countries can move toward and not moving targets.

We can strengthen some of the indicators, particularly the budget indicator, the trade indicator, the expenditure items, and the business days. There are several that can be improved; others that can be added, the ratio of boys to girls in school, school enrollment ratios, private sector—the State control of private sector assets and some other health indicators.

There is several ways that that these indicators can be strengthened and improved. And for those reasons, I think it should not—those—the 16 indicators should not be legislated. But I do think it is important that the administration be required to report regularly to Congress on exactly what the process is and exactly what the outcomes are, so that—and to consult with you so that you can add your views as to how to improve the system as it goes forward.

The second big issue is the corporation itself. There are some advantages of a new corporation. It could reduce political pressures. It could improve on bureaucratic procedures and move out of the way of the multiple mandates that USAID now operates under.

But it could also further fragment foreign assistance policy. It could lead to redundancy, to more confusion. It could impede coordination and create rivalries.

It seems odd to me to have multiple Presidential appointees in charge of foreign assistance policy.

It could work out, but it will need to have much stronger coordination, with USAID on the board, perhaps plus some outsiders on the board, not just government officials as we do with OPIC and AXIOM. There should be clear methods of coordination. I think Mr. Natsios' testimony deserves careful study for their ideas for further coordination.

There needs to be much more adequate staff of the corporation, particularly on the ground. I do not see how this program can be run effectively with 100 people on the ground, and I think there is a danger that it could be starved before it gets off the ground. We need good staffing on the ground to make this work.

The third issue is the opportunity to improve operations on the ground. The contracts are a good idea, but in the—and the proposals are a good idea, but the administration is now proposing

that these only come through the governments. And I think that is a mistake.

It needs to be an open process with other entities within the recipient countries eligible to write proposals, including NGOs, sub-national governments, and others.

There is a danger in its current proposal that it could enlarge the size of recipient governments, which is something that we do not want.

Related to this, we must have a very strong monitoring and evaluation program on the ground. And the administration has not unveiled its plans for how it is going to do that, but it is absolutely central to making sure the countries meet the standards that are there, achieve the benchmarks, how we allocate funds to the best programs and how we can think about reducing funds when programs fail.

There needs to be an independent monitoring and evaluation process, and that has not yet been spelled out.

On the ground also, development takes time. There was talk this morning about the need for countries to move off onto a sustainable basis. Development takes a long time.

Ghana, which may—is a good candidate for this program, their current income is \$350 per year. If they grow at 7 percent per year per capita, a very, very high growth rate, it will take them 20 years to reach \$1,435, the standard of just the first group in the MCA. And it will take many more years to reach \$2,975.

Development takes a long time. Twenty years of great performance might get Ghana to a graduation level.

Finally, we have to have strong clear programs for countries that do not qualify. Only a small number of countries will qualify for this program. I think that is OK, because it brings with it a way to bring those countries in in a much more flexible way.

But we have to have other kinds of programs to deal with the many countries that do not qualify. Mr. Natsios laid out some preliminary plans this morning. We need to look at those more carefully. But we need to think very creatively about the countries that do not quite qualify, the countries that are mediocre, countries that are failed and weak States, and how we can modify our current programs to make them much stronger in order to achieve our development goals in those countries. Thank you very much.

The CHAIRMAN. Thank you very much, sir.

[The prepared statement of Dr. Radelet follows:]

PREPARED STATEMENT OF STEVEN RADELET, 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.

Overall, the MCA initiative is worthy of strong 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 four 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.

I first comment on the strengths of the administration's proposal, and then on each of the four 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.

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.

¹For a detailed description see Steve Radelet, "Qualifying for the Millennium Challenge Account," <http://www.cgdev.org/nv/Choosing-MCA-Countries.pdf>

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 on each indicator from median scores to fixed levels (e.g., a 75% immunization rate). Median scores will change from year-to-year, creating a moving target for countries hoping to qualify.
- 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, further 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 fall, funding should be directed elsewhere. Being true to this principle will certainly distinguish MCA from existing aid programs.

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 an 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.

²See 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. Of particular importance are the countries that just miss qualifying for the MCA, the so-called "tier II" countries.

One approach would be to expand the MCA to include a larger number of countries. But this could dilute the basic promise of the program: keep it narrowly focused, fund the countries generously, and provide them with more flexibility. If the group of countries were expanded to those with weaker governments, it would be more difficult to provide recipients with the responsibility and flexibility that offers the most promise of setting the MCA apart.

A better approach would be for USAID to work 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.

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 2. Rule of Law 3. Voice and Accountability 4. Government Effectiveness 5. Civil Liberties 6. Political Rights	World Bank Institute World Bank Institute World Bank Institute World Bank Institute Freedom House Freedom House
II. Investing in People 7. Immunization Rate: DPT and Measles 8. Primary Education Completion Rate 9. Public Primary Education Spending/GDP 10. Public Expenditure on Health/GDP	WHO/World Bank World Bank World Bank World Bank
III. Economic Freedom 11. Country Credit Rating 12. Inflation 13. Regulatory Quality 14. Budget Deficit/GDP 15. Trade Policy 16. Days to Start a Business	Institutional Investor IMF World Bank Institute IMF/World Bank Heritage Foundation 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 2. Bangladesh 3. Bolivia 4. The Gambia 5. Ghana 6. Georgia 7. Honduras 8. Lesotho ¹ 9. Malawi 10. Mongolia 11. Mozambique 12. Senegal 13. Sri Lanka	Bangladesh Bolivia China Honduras Lesotho ¹ Malawi Mongolia Philippines Senegal Sri Lanka Vietnam	Bulgaria Egypt Namibia South Africa
ELIMINATED CORRUPTION 1. Moldova 2. Nicaragua 3. 4.	Ecuador Moldova Nicaragua Ukraine	
MISSED BY ONE INDICATOR 1. Cambodia 2. Guyana 3. India 4. Mali 5. Nepal 6. Uganda 7. Vietnam 8. 9. 10. 11. 12. 13.	Albania Cambodia The Gambia Georgia Ghana Guyana India Kazakhstan Kyrgyz Rep. Mali Morocco Mozambique Uganda	Jamaica Jordan Tunisia

¹For 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 incomes less than \$1,435	Countries with incomes less than \$1,435	Countries with incomes between \$1,435-\$2,975
Development Status:			
GNI per capita, 2001	\$380	\$460	\$1,965
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

The CHAIRMAN. Ms. McClymont.

STATEMENT OF MARY E. McCLYMONT, PRESIDENT AND CEO, INTERACTION, WASHINGTON, DC

Ms. McClymont. Thank you very much, Mr. Chairman, for the opportunity to testify before you and the committee. I am pleased to present today some of the views of InterAction members, as well those of the broader NGO development coalition that has actually been working together around the MCA over the last several months. InterAction has co-chaired that effort with the organization, Bread for the World.

InterAction is the largest alliance of U.S.-based relief and development organizations, and our 160 members operate in all of the developing countries and have decades of experience in development on the ground. Both faith-based and secular, InterAction members reach millions of Americans who support foreign assistance programs.

President Bush's announcement of the new MCA has really galvanized our community with great interest and support. Not only would, of course as everybody has said, these be significant new resources, but importantly, the President has also underscored that these would be used to "fight world poverty."

He has said in other places that expanding the circle of development is a "moral imperative" and a U.S. foreign policy priority.

Moreover, we believe that the MCA, as you have said, Mr. Chairman, provides the opportunity to relook and revitalize and perhaps redefine some of our U.S. foreign assistance policy and programs and really maximize their effectiveness.

Although the administration, we believe, has articulated a very powerful vision to transform development, many unanswered questions remain. And we look forward to working with you to further define the MCA and its relationship to the broader foreign aid program.

We have put forward some recommendations. They are attached to my testimony. But before, I turn to just highlighting several of them, I would like to place the MCA in the broader context of U.S. development assistance and foreign policy.

We believe the MCA must be seen as just one tool to stimulate broad-based economic growth and prosperities in developing countries. To leverage it, we need a comprehensive U.S. strategy to guide all of our development through not only programs of assistance, but thinking through coherence around trade, economic policies, debt relief, and private investment flows.

This broader strategy then could go guide and hopefully bring more coherence among and between the various development assistance programs and enhance the whole effort.

So to be successful, the MCA must be seen in this larger strategy for needs development, and not in a vacuum. As many have said, the MCA is intended to be a bonus pool for a small group of countries, not meant to replace the development assistance for the many poor countries that will not qualify. Neither is it intended to address humanitarian concerns such as disaster response or refugees, or those that need a global strategy, such as HIV/AIDS. Yet, these objectives are also critical.

Countries in which peoples' basic needs are met are more stable. It makes for a more stable world.

So we underscore, and Mr. Chairman we thank you for your remarks, funds for the MCA should be in addition to and not a substitute for other core bilateral development and humanitarian programs.

In short, we need to ensure that the core development programs work together with the MCA to accomplish our goals.

I will now try to highlight—I am going to touch very briefly on seven of our key principles, our priorities for your consideration, Mr. Chairman. And I give more detail in our submitted testimony.

First, the purpose. We urge the MCA funds be targeted for poverty-focused development, advancing the Millennium development goals in the poorest nations.

In announcing the MCA, the President endorsed these so-called Millennium development goals, which are really internationally agreed targets to cut in half poverty and improve health and education. These goals, among them to educate children, help mothers and children stay alive, and reduce hunger, are all concrete concerns we have discovered through our polling, are things Americans believe our assistance programs, development assistance programs should support.

Importantly, these goals might be able to provide an overarching framework for the MCA and have several advantages. They could leverage more donor support, and they could try to bring everybody into the circle, and get international buy-in from other donors to leverage our money.

Second, country eligibility, the MCA should, we believe, target the strongest performers in the poorest countries, specifically the low-income countries under IDA. These low-income countries, as Mr. Radelet has suggested, lack good access to or means of attracting other financial resources and they are much more in need of

assistance per se largely than the lower middle income countries that the administration would bring in in year 2006.

If there is a concern about not enough poor countries meeting eligibility, we would propose that perhaps the pool will be expanded by providing a lesser amount of MCA funds for sort of a second tier of countries, which would be the near-miss countries that just do not quite qualify.

Third, program design, we wanted to stress this point, Mr. Chairman. Developing countries should be full partners in the entire process. Funding decisions should follow the principle of country ownership.

Programs for recipient countries should be designed through consultations with, and implemented by, civil society, local governments, private sector, as well as the national government, and we believe should be based on national development strategies within the country.

Fourth, the MCA assistance should utilize multiple funding mechanism, not only government to government grants, but also direct funding to civil society organizations, international NGOs, as well as local governments. The administration's proposal appears to contemplate this approach, and I want to stress—or what I believe, is the importance of civil society.

A robust civil society is critical to achieving good governance, accountable governance in a country, and also for providing more equitable delivery of services at the local level, which helps many marginalized people in a society.

Five, women's participation is essential to the success of all development strategies, and it is critical that gender be fully considered in the design implementation and evaluation of the MCA programs.

Six, because broad-based economic growth and social development do, as Mr. Radelet suggests, take time, it is important that country agreements set reasonable timetables and expectations to be met. A careful balance, we believe, should be struck between the shorter timeframes for program support the administration seeks and a longer term commitment to these countries required to truly reduce poverty and bring broad-based economic growth.

And finally, Mr. Chairman, the issue of the structure. We, our coalition, have proposed a separate, semi-autonomous office within USAID to implement the MCA, with new authorities and procedures that could enable a faster, more flexible, and more innovative set of programs.

This approach would allow several things, for the MCA to help reform and revitalize USAID where needed, enable its expertise—and that is to say USAID's experience and expertise—to guide the MCA, and hopefully bring more policy coherence and less fragmentation to our foreign assistance programs.

Should the Congress agree with the administration's approach to establish a separate entity, we would recommend at least three key steps for strong linkages to and a meaningful role by USAID. No. 1, the MCC should use the existing mechanisms and improve them where needed at USAID for implementing programs and disbursing funds.

Two, the MCA should contemplate—which does contemplate 100 staff people only, should make use of the field structure of USAID, rather than trying to establish a new presence in MCA countries.

And third, we believe USAID should be brought on the board of the MCC so it can offer its strong institutional experience to inform policies and judgments.

In short, the MCA will include only a small group of countries. But USAID continues to struggle with the difficult challenge of the many other developing countries, including the failed States and also including those poor countries, which are struggling very hard in the development process.

In those countries, development assistance targeted to reform-oriented leaders, institutions, and communities can truly make a difference and really lay the foundation for future reform.

So with that, I will close, Mr. Chairman. Thank you very much.

The CHAIRMAN. Well, thank you very much, Ms. McClymont.

[The prepared statement of Ms. McClymont follows:]

PREPARED STATEMENT OF MARY E. MCCLYMONT, PRESIDENT AND CEO, INTERACTION

Thank you, Mr. Chairman, for the opportunity to testify before this Committee on the Millennium Challenge Account. I also want to acknowledge the leadership and support that you, Senator Biden, and many others on this Committee have provided on issues of importance to those of us in the humanitarian and development community. I am grateful for the opportunity to present some of the views and perspectives of InterAction members and the broader NGO development community on the Millennium Challenge Account.

InterAction is the largest alliance of U.S.-based international development and humanitarian nongovernmental organizations. Our 160 members operate in every developing country and have decades of experience on the ground in working to overcome poverty, exclusion and suffering by advancing social justice and basic dignity for all. While many in our membership have a long and successful history of partnership with U.S. government agencies, collectively, the members receive \$3 billion in annual contributions from private donors, including direct contributions from the American people. Both faith-based and secular, InterAction members are headquartered in 25 states and have branch offices and/or constituencies in every state in the country. Furthermore, when you look at the donors, sponsors, and supporters of our member organizations, InterAction reaches millions of Americans who care about and support in some form our foreign assistance programs. I come before you to reflect views from this broad-based coalition.

President Bush's announcement in March 2002 of a new "Millennium Challenge Account" (MCA) has galvanized great interest and support from the development community. Under the MCA, the President has pledged additional funds beginning in FY 2004, leading to a \$5 billion annual increase in development assistance over current levels by 2006. According to the President, funds would go to selected countries that govern justly, invest in people, and encourage economic freedom. These are *new* and *significant* resources. Importantly, the President has also made clear that the funds will be used to "fight world poverty" and "bring hope and opportunity to the world's poorest people." It is a significant signal that the United States must play a much larger role in fighting world poverty, a point the President recognized by making it a "moral imperative" and a U.S. foreign policy priority. Indeed, development is now a key component of the National Security Strategy.

In announcing this pledge, the President endorsed internationally-agreed targets for cutting in half extreme poverty around the world and for substantial improvements in health and education in developing countries by 2015, known as the "Millennium Development Goals". These goals, which include improving access to basic education, helping mothers and children stay alive, advancing the status of women and girls, improving access to clean water, and reducing poverty and hunger, are all concrete concerns supported by the American people, based on polling commissioned by InterAction and other organizations.

In fact, 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. Indeed, the MCA provides the 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.

For these reasons, the new initiative must be shaped and defined in a careful and comprehensive way. The Administration has articulated a powerful vision to transform development; yet, many unanswered questions remain as to what this assistance will fund, how it will be implemented and how it will relate to other foreign assistance programs of the U.S. government. We hope that this Committee and your colleagues in the House of Representatives will take up the challenge and work to further define and shape the MCA and its role and relationship to the rest of our foreign aid program. We look forward to working with you and with the Administration to fashion an innovative and effective fund.

To that end, InterAction has developed a set of recommendations as to how the new account should be developed and implemented. We have brought together 40 of our member organizations and the broader development community to create a consensus around a set of principles and priorities for the MCA. InterAction developed a policy paper in May, and subsequently with the broader community, a legislative proposal that we have shared with Members of Congress and with the Administration. With your permission, Mr. Chairman, I would like to submit for the record our initial policy paper, *The Millennium Challenge Account: A New Vision for Development*, along with our legislative proposal on the MCA.

I will touch on several of our specific recommendations in a moment, but first let me place the Millennium Challenge Account in the context of a broader reassessment of U.S. development assistance and foreign policy.

THE LARGER FRAMEWORK

Although it represents a significant step forward, the MCA must be seen as just one tool to stimulate broad-based economic growth and prosperity in developing countries. To leverage it, a comprehensive U.S. development strategy should be designed. This strategy should include clear goals, realistic timetables, and sufficient resources for reducing poverty and meeting the Millennium Development Goals through programs of assistance, trade and economic policies, debt relief and private investment flows. It should identify strategies to promote development in the countries that will not be eligible to receive assistance under the new account, and address such complex issues as how the Millennium Development Goals can be met by finding new ways to deal with trade barriers, debt reduction and tied aid.

To be successful, the Millennium Challenge Account must be seen within this larger strategy for development. In short, the MCA cannot be considered in a vacuum if "the advance of development," which the President has called a "*central* commitment of American foreign policy," is to be truly realized. After all, as the President has defined it, the MCA is a bonus or incentive pool of large, concentrated assistance that will be directed to a small, select group of countries that meet the eligibility criteria set forth in the President's proposal. It is not meant to replace the development assistance being provided largely by the U.S. Agency for International Development (USAID) to poor countries that for the most part do not meet the rather stringent criteria. And I will come back to that point. Further, the President has underscored that funds for the MCA would be in addition to, and not a substitute for, other core bilateral development and humanitarian programs.

In February 2002, one month prior to the President's announcement, InterAction launched a campaign, the Global Partnership for Effective Assistance, a multiyear effort to save lives and build self-sufficiency by increasing development and humanitarian assistance, improving aid effectiveness, and building international partnerships. In the broadest sense, this campaign aims to help reinvigorate America's role in partnering to build safer, more stable and democratic societies. Effective assistance programs with concrete, realistic goals and adequate funding are key ingredients for reducing poverty and meeting basic needs. The issue is not only about how *much* money is spent, but also *how* the money is spent. To that end, we are working to influence the policy debate and raise public awareness about the importance of aid effectiveness.

The MCA initiative, which we strongly advocate for in our campaign, can be a critical new instrument of policy to fight poverty. Yet, as noted, it envisions funding for a limited number of qualifying countries and does not address the development needs and objectives in the many nations that won't qualify. The initiative also does not take into account humanitarian concerns such as disaster response and refugees, or areas that may need a global or regional strategy, such as HIV/AIDS. Yet we know that these objectives are critical and that countries in which peoples' basic needs are met are more stable and less prone to conflict.

That is why InterAction's campaign urges that the MCA be seen as a part of the overall aid strategy, and that existing bilateral aid programs in the foreign operations budget be increased. These programs build self-sufficiency by promoting basic education, healthcare, job and business skills, reducing hunger, women and girls, refugee and disaster response, and peace and democracy. In short, programs funded under these core accounts, if carried out effectively, can build capacity in people and lay the groundwork for additional nations to qualify for the MCA in future years.

It is critical, therefore, that funding for these programs not be cut or diverted to fund the MCA. We must also guard against the fragmentation of our foreign aid program that can lead to uncoordinated, inefficient and duplicative use of resources. Instead, we must ensure that core development programs work together with the MCA to meet the international goals for poverty reduction, promote broad-based economic growth, and help create a better, more secure world. If we do it right, the MCA can serve as the catalyst for a comprehensive and coherent new aid policy that recognizes progress and encourages change.

We believe the Millennium Challenge Account offers an opportunity to maximize the impact of our development assistance. Behind the new initiative should be an understanding that for development to succeed in the long run, there must be the right mix of good policies, sufficient resources, measurable goals, coordination among donors, effective innovative delivery mechanisms, and the program ownership and participation of developing nations. Both sides of the development equation—rich and poor countries alike—must make a commitment to reform, and hold themselves accountable for the results.

THE MCA

With this broader context in mind, I will highlight several of the key principles and priorities of concern to us that I hope you and your Committee, Mr. Chairman, will keep in mind as you work to shape and define the Millennium Challenge Account in the months ahead.

Purpose

- We urge that funds from the new account targeted for *poverty—focused development*—advancing the *Millennium Development Goals* in the poorest nations. These goals provide a broad framework for the MCA, including parameters for the sectors on which the MCA should focus. Furthermore, they serve as useful mechanism to both leverage funding from other donors and to secure international support for this new framework for development. And, the American public is supportive of the concerns addressed under the MDGs, such as basic education, and advancing the status of women and girls.
- In its proposal, the Administration has indicated that the goal of the MCA is “to reduce global poverty through increased economic growth.” It is correct to highlight the *importance of economic growth*, as there is ample evidence that sustained growth is essential to poverty reduction in developing countries. However, it is also clear that *growth by itself is not sufficient*. While we agree about the importance of economic growth in helping countries meet their development objectives, it must be broad-based growth that is built on policies that promote equity, reduce poverty, and provide robust investments in people. Achieving a just, equitable pattern of growth and development has important implications for the type of investments to be financed by the MCA.

Country Eligibility

- The MCA should *target strong performers among the poorest countries*. The Administration's proposal, however, would also allow lower-middle income countries to be eligible in 2006 and beyond. We recommend targeting MCA assistance to low income countries eligible to borrow from World Bank International Development Association (IDA). Many of the lower middle income countries do indeed have many poor people and face significant development challenges. They, however, also have better access to means of attracting other financial resources and are less in need of the MCA assistance than the low-income countries.
- 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. Our legislation call 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.

- With regard to the specific indicators as outlined by the Administration, we welcome the use of publicly-available indicators to select MCA countries because that approach offers a potential for transparency and allows for monitoring of the selection process by civil society and other interested parties. There are several details of the criteria and selection process, however, on which our members have differing views. InterAction has not made specific recommendations on the indicators themselves.

Program Design / Funding Process

We suggest in our legislative proposal “implementation agreements” between recipient countries and the United States which would establish the funding parameters and guidelines under which proposals could be submitted by various governmental, private sector, and civil society or NGO actors. The Administration’s proposal does not detail how its MCA contract relates to the proposal process.

- Developing nations should be partners in the formation and implementation of the new account, and broad participation of the private sector and civil society should be evident throughout. 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. MCA assistance programs for recipient countries should be designed through consultations with, and implemented by, *civil society, local governments and the private sector as well as the national government*. The MCA should support locally conceived and implemented national development strategies such as the Poverty Reduction Strategy Papers (PRSP). The Administration’s proposal is properly supportive of country ownership and broad consultation, but this language could be reinforced and further defined.
- *Women’s participation* is essential to the success of all development strategies. For example, the World Bank has noted that countries can significantly boost productivity and economic growth by focusing on the abilities and potential of their women. To benefit from these synergies, it is critical that gender be fully considered in the design, implementation and evaluation of MCA programs.
- Because broad-based growth and social development take time, it is important that country agreements or contracts set *reasonable timetables and expectations*. The Administration has indicated it would like to see results in short timeframes. A careful balance must be struck, however, between shorter timeframes for program support, and a longer-term commitment to poverty reduction and broad-based growth. Exit strategies for ending aid should be carefully planned in collaboration with recipient countries.
- The MCA assistance should utilize *multiple funding mechanisms* including, but not limited to, government to government grants, as well as direct funding to civil society organizations, international private voluntary organizations, as well as local governments. The Administration’s proposal appears to contemplate this approach. I stress the importance of civil society and private voluntary organizations because, even in the best performing nations, governments often do not have open transparent and inclusive processes to engage civil society. And yet, a robust civil society is critical to achieving good, accountable governance. NGO and civil society implementers also help ensure a more equitable delivery of services at the local level, particularly to segments of the population that might otherwise be neglected or marginalized.
- *Donor coordination* is important to increase effectiveness and reduce wasteful financing. The United States cannot undertake the global development challenge on its own. We must leverage the resources of other donors and, more importantly, of the developing countries themselves. Too often, competing requirements from different donors place undue burdens on developing countries. The MDG framework provides one mechanism to ensure donor coordination since the international community has already agreed to these targets. Using national development strategies or PRSPs is another. The Administration’s proposal acknowledges the importance of donor coordination. However, it places the burden solely on recipient countries. We believe responsibility should be borne by both the donor and developing countries.

Implementation Structure

- We have proposed a separate, semi-autonomous office within USAID to implement the MCA, with new authorities and procedures that enable faster, more flexible and more innovative programming to assure funds are programmed effectively and expeditiously. Such an approach would allow for the MCA to help reform and revitalize USAID, enable its experience and expertise to guide the

MCA, and help further policy coherence and coordination among various foreign assistance programs.

- The Administration proposes to set up a new entity to implement the MCA, the Millennium Challenge Corporation. If the Congress agrees with the Administration's approach to establish a separate entity, it will be critical to avoid duplication of effort, competing priorities and contradictory policies. We would therefore recommend the following steps to *establish strong linkages to and a central meaningful role for USAID in order to foster policy coherence in our development programs.*

(1) The MCC should utilize, and improve upon, where necessary, existing mechanisms at USAID for implementing programs and disbursing funds.

(2) The MCC, which contemplates only about 100 staff, should make use of the field infrastructure of USAID rather than trying to establish a new presence in MCA countries. This will also help improve coordination between USAID run programs and MCA programs.

(3) 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.

I conclude with a few words on the continuing role and importance of USAID in our development and foreign policy. The MCA will likely include only 15 to 20, selected countries. USAID, however, continues to have the difficult challenge of assisting the larger universe of developing countries. It includes a group of failed, or failing, states which require largely humanitarian assistance, such as disaster aid or HIV/AIDS funds. There are also many other low income countries that are struggling in the development process, making progress in one area and falling back in another. 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.

We 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. Mr. Chairman, your Committee will play a pivotal role in shaping this initiative. Many questions remain to be addressed on the MCA and we welcome the opportunity to work with you in the weeks and months ahead.

[Attachments]

THE MILLENNIUM CHALLENGE ACCOUNT: A NEW VISION FOR DEVELOPMENT
A POLICY PAPER FROM INTERACTION—MAY 2002

FOREWORD

These recommendations on the creation and implementation of the Millennium Challenge Account are offered by InterAction, the largest alliance of U.S.-based international development and humanitarian nongovernmental organizations. With more than 160 members, both faith-based and secular, operating in virtually every developing nation, we work to overcome poverty, exclusion and suffering by advancing social justice and basic dignity for all.

This paper offers a set of recommended guidelines for the design and implementation of the Millennium Challenge Account for overseas development, announced by President Bush in March 2002. The paper was developed through consultations with our membership. We hope it will serve as an important resource for policymakers as they craft this new initiative. Our InterAction community looks forward to an open and constructive ongoing dialogue with the Administration and the Congress on the Millennium Challenge Account in the months ahead.

EXECUTIVE SUMMARY

The Millennium Challenge Account (MCA) presents a unique moment to fundamentally transform U.S. development policy and maximize its impact. Success of the MCA 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.

The purpose of the MCA should be to demonstrate how poverty can be reduced and the Millennium Development Goals (MDGs) can be met through the right mix of good policies, sufficient resources, measurable goals, coordination among donors, effective innovative delivery mechanisms, and the program ownership and participa-

tion of developing nations. Rich and poor countries alike must make a commitment to reform, and to hold themselves accountable for results.

Although the Millennium Challenge Account is a significant step forward, it is just one tool to stimulate broad-based economic growth and prosperity in developing countries. To leverage the Millennium Challenge Account, a comprehensive U.S. development strategy should be designed. It should have clear goals, realistic timetables, and sufficient resources for meeting the MDGs through programs of assistance, trade and economic policies, debt relief and private investment flows.

The debate over the Millennium Challenge Account has only begun, and the broader question, how it helps redefine U.S. development policy, will not be answered by a single paper any more than it will be answered by a single meeting. Rather, the solutions will be multi-layered and subject to alterations until the right fit is achieved. This paper, which includes key design and implementation guidelines, should be viewed in the same way, as an initial framework for policymakers designing the Millennium Challenge Account, and positioning it in the broader mosaic of an overarching foreign policy.

SUMMARY OF KEY GUIDELINES FOR THE MILLENNIUM CHALLENGE ACCOUNT

Focus

- Funds from the new account should be used to advance the Millennium Development Goals.
- Funds from the new account should focus on the poorest countries.

Eligibility

- Eligibility criteria should serve as an incentive, rather than a reward, for good performance.
- The impact of the MCA will be closely related to the level of funding provided for a country, which is why there should be a limited number of nations that receive funding each year.

Implementation and Administration

- Developing countries should be partners in the development and implementation of the new account, and broad participation of the private sector and civil society should be evident throughout.
- Assistance under the new account should not be provided exclusively to national governments.
- Benchmarks for success should be built into the Millennium Challenge Account.
- Interagency coordination will be critical to the success of the MCA, and a lead agency should be designated to administer the distribution of funds.
- Improved donor coordination and policy coherence are crucial if the MCA is to succeed and the MDGs are to be met.

The Broader Framework

- Because only a limited number of countries will qualify for assistance under the Millennium Challenge Account, it is vital that the new account complement other development programs.
- Funds from the Millennium Challenge Account must be provided as an addition to, not a substitute for, other development and humanitarian programs.
- There must be strong linkage to humanitarian and refugee assistance efforts.

THE MILLENNIUM CHALLENGE ACCOUNT: A NEW VISION FOR DEVELOPMENT

In March 2002, the International Conference on Financing for Development in Monterrey, Mexico, brought world leaders together to discuss ways of building a more prosperous world community. They sought commitments by both rich and poor nations to help reach a set of internationally-agreed targets for the halving of extreme poverty around the world and for substantial improvements in health and education in developing countries by 2015. Endorsed by 189 countries at the September 2000 U.N. Millennium General Assembly, collectively these are known as the Millennium Development Goals (MDGs).

At the time of the Monterrey conference, President Bush indicated America's support for these goals. He reaffirmed the commitment of the United States to bring hope and opportunity to the world's poorest people and pledged new resources to fight world poverty. The funds would be provided through a "Millennium Challenge Account," which would increase U.S. development assistance over three years, leading to a \$5 billion annual increase above current levels by 2006.

InterAction applauds President Bush's commitments and pledges to work in partnership to make the MCA a success. InterAction, the largest alliance of U.S.-based international development and humanitarian nongovernmental organizations, with 160 members operating in virtually every developing country with local partners, is uniquely positioned to offer guidance on maximizing the new account's effectiveness in the fight against poverty.

A NEW VISION FOR DEVELOPMENT

The Millennium Challenge Account (MCA) presents a unique moment to fundamentally transform U.S. development policy and maximize its impact. Success of the MCA 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.

The purpose of the MCA should be to demonstrate how poverty can be reduced and the Millennium Development Goals can be met, through the right mix of good policies, sufficient resources, measurable goals, coordination among donors, effective innovative delivery mechanisms, and the program ownership and participation of developing nations. Rich and poor countries alike must make a commitment to reform, and to hold themselves accountable for results.

Although the Millennium Challenge Account is a significant step forward, it is just one tool to stimulate broad-based economic growth and prosperity in developing countries. To leverage the Millennium Challenge Account, a comprehensive U.S. development strategy should be designed. It should have clear goals, realistic time-tables, and sufficient resources for meeting the MDGs through programs of assistance, trade and economic policies, debt relief, and private investment flows. It should identify ways to reach people in the countries that will not be eligible to receive assistance under the new account, and address such complex issues as how the MDGs can be met by finding new ways to deal with trade barriers, debt reduction and tied aid. To be successful, the MCA must be placed within this larger strategy for development.

President Bush made another pledge at the Monterrey conference, to "jump-start" the Millennium Challenge Account by "working with Congress to make resources available over the next 12 months for qualifying countries." Initiating the MCA in FY 2003 will illustrate on the part of President Bush and his administration an understanding that there is no time to waste on beginning the implementation of this initiative. But a down payment on the promise of the MCA should not come at the expense of other critical assistance programs, which is why funds to jumpstart the program should be added to—not deducted from—existing humanitarian and development accounts.

The debate over the Millennium Challenge Account has only begun, and the broader question, how it helps redefine U.S. development policy, will not be answered by a single paper any more than it will be answered by a single meeting. Rather, the solutions will be multi-layered and subject to alterations until the right fit is achieved. This paper, which includes key design and implementation guidelines, should be viewed in the same way, as an initial framework for policymakers designing the Millennium Challenge Account, and positioning it in the broader mosaic of an overarching foreign policy.

As the Millennium Challenge Account evolves, questions about specific aspects of legislation and implementation that are not addressed in these initial recommendations will undoubtedly arise. While InterAction plans to actively monitor the way in which the MCA is shaped, we feel our community being one of the trusted partners in the entire process will be a key ingredient to its ultimate success. We look forward to providing additional information and guidance as the process moves ahead. Some of the member organizations of InterAction also will be submitting their own policy papers in the coming weeks, with recommendations based on their particular areas of expertise.

KEY GUIDELINES FOR THE MILLENNIUM CHALLENGE ACCOUNT

In defining and implementing the Millennium Challenge Account, decisionmakers should follow 12 key guidelines.

Focus

1. Funds from the new account should be used to advance the Millennium Development Goals.

Development has worked where there has been a sharp focus on poverty reduction and on specific programs and policies that address the MDGs. Countries requesting assistance should develop their own strategies to address these goals.

2. Funds from the new account should focus on the poorest countries.

Although there are desperately poor people even in middle- and high-income countries, the Millennium Challenge Account should focus on the countries with the lowest per capita incomes—those eligible to borrow from the International Development Association.

Eligibility

3. Eligibility criteria should serve as an incentive, rather than a reward, for good performance.

President Bush said that for a nation to participate in the MCA it should show evidence of ruling justly, investing in the health and education of its people, and encouraging economic freedom. While it makes sense to focus on countries that fully meet these criteria, setting the bar too high could further alienate those facing the greatest challenges. If only the best performers are eligible to receive assistance, then aid will go to those who least need it. Many countries, particularly those in Africa, will once again be left behind. At the same time, if eligibility criteria are not sufficiently rigorous, there is a danger that recipients will be chosen for political reasons.

Assuming that the selected countries truly meet these criteria, and assuming that funds are used only to advance the Millennium Development Goals, Congress should provide the kind of flexibility in programming that enables quick and effective obligation of funds. If additional earmarks, restrictions and conditions are imposed, important opportunities for cooperation will be missed, and the transforming effect of the Millennium Challenge Account will have been negated.

Elaborating on the president's eligibility criteria, recipient countries should have demonstrated a commitment to, and should be taking steps toward:

- Good governance for all of their people, including the poor, through expanding democratic participation, rooting out corruption, upholding human rights, encouraging a free press, protecting and treating displaced people, refugees and asylum seekers fairly, advancing opportunities for women, encouraging the development of civil society, and adhering to the rule of law;
- Investing in the health and education of their people, with careful attention to the needs of women and girls, through budgetary policies that seek to develop human capacity and build sustainable development;
- Economic policies that foster enterprise development, private investment, poverty reduction and prosperity, while taking into account differential impacts on women and men.

4. The impact of the MCA will be closely related to the level of funding provided for a country, which is why there should be a limited number of nations that receive funding each year.

For the MCA to be successful, allocations from the new account must be large enough to make a real impact on the lives of large numbers of people by leveraging the kinds of policy changes and resource commitments that will make the impact significant.

Implementation and Administration

5. Developing countries should be partners in the development and implementation of the new account, and broad participation of the private sector and civil society should be evident throughout.

Once nations have been found eligible for funding, allocations from the Millennium Challenge Account should be made in response to comprehensive national plans or proposals from the developing countries.

Rather than asking a country to produce an entirely new strategy for assistance, a proposal should be based on a nation's own national development strategy, such as the World Bank and IMF-initiated Poverty Reduction Strategy Papers (PRSPs). To date, however, the PRSP process has not been consistently open or accountable and, in some cases, it has been conducted without the participation of women and civil society organizations. Yet, the benefits of executing the PRSP process as envisioned could produce such clear benefits as local ownership, donor coordination, and policy coherence.

A recipient's proposal should identify the programs and projects for which it is seeking assistance, describe specific development goals and targets to be achieved, and provide measurable indicators of success. These plans should detail the involvement and participation of other donors, host governments (local and national), private businesses, civil society groups and nongovernmental organizations. This will help ensure accountability, transparency and local ownership. In turn, the MCA would foster donor coordination and private-public partnerships, while ensuring that

recipient countries assume responsibility for successful implementation of the programs.

6. Assistance under the new account should not be provided exclusively to national governments.

In addition to governments, other channels should be used for the implementation of the MCA, including nongovernmental organizations, civil society groups, regional and local governments, international organizations, or multilateral development banks. In these cases, such entities should be eligible to receive funds directly from the new account, as appropriate.

While part of the purpose of the Millennium Challenge Account is to strengthen governments that are undertaking the right combination of policies, many of them are not yet able to provide adequate monitoring and controls over funds. Moreover, working through humanitarian, developmental and civic organizations, which have built relationships of trust and respect with intended beneficiaries in local communities, is essential to maximizing aid impact and ensuring it reaches people who need it.

It should be made clear, however, that funds from the MCA will not be used to meet ongoing U.S. commitments to international institutions. Further, since one of the greatest challenges to successful development has been the overhang of crippling debt, funds from the account should be provided only in the form of grants, not loans.

7. Benchmarks for success should be built into the Millennium Challenge Account.

To determine effectiveness and ensure accountability, clear indicators of success need to be established for programs at the country level *and* for the overall MCA. The assistance targets should be part of the conditions for the grant, and they should be agreed upon by all parties. A certain amount of flexibility should be factored into the measurements of success for any program, but not so that it compromises accountability.

Because broad-based economic growth and social development take time, the selection of indicators and measures should be realistic and thought of as intermediate steps. For example, investments in the health and education of a population may take a generation or more to "pay off" in terms of productivity and earnings.

Technical assistance should be available to help countries devise indicators of success and measure results. The MCA should make a special effort to help strengthen local capacity in evaluation and monitoring skills and tools, both among governmental personnel and within civil society.

Just as recipients will be held accountable for meeting their goals under the MCA, industrialized nations should be held accountable for meeting their commitments to broader development targets embodied in the Millennium Development Goals. To that end, a system should be devised for measuring how the success of the MCA and other U.S. development programs contribute broadly to the MDGs.

8. Interagency coordination will be critical to the success of the MCA, and a lead agency should be designated to administer the distribution of funds.

Ensuring that the funds are spent accountably and that the goals or benchmarks are met will require expertise in all aspects of political, social and economic development, reflected in the involvement of several federal agencies or offices.

Once decisions on criteria and country eligibility are made at the interagency level, an agency with a commitment to poverty reduction, experience in conducting successful development projects, and personnel based in recipient countries will be needed to actually administer the account. Given the mission of the MCA, the current structure of the U.S. government, and the bureaucratic difficulties of building a new entity to manage development, the U.S. Agency for International Development (USAID) is well positioned to administer the program. Since a large infusion of aid could overwhelm USAID's current system, it would likely need to establish a separate implementing office.

If the intention of the Millennium Challenge Account is to reshape the way in which the U.S. government views, and conducts, development assistance, then the tools and methods employed for these tasks must also change. The agency should also have procedures and practices that support creativity, innovation, flexibility and quick response to ensure that funds from the account are programmed effectively and expeditiously.

Further, additional funds should be made available to cover administrative expenses of the administering agency. Costs such as salaries, operating expenses, evaluation and monitoring, and technical assistance to meet and measure criteria can constitute a sizeable percentage of the grant value.

9. Improved donor coordination and policy coherence are crucial if the MCA is to succeed and the MDGs are to be met.

One of the reasons that assistance programs have not been more effective in the past is that donor countries fail to agree on common goals and objectives, standards, and requirements. Each donor, bilateral and multilateral, requests different types of information and documentation from the recipient government, while recommending different policies and imposing different types of conditionality. There are gaps and contradictions as well as duplication and overlap, leaving even the most dedicated reformers without viable options. These shortcomings could be alleviated by using the Millennium Development Goals as a common set of objectives and a country's national development strategy as the agreed blueprint.

At the Monterrey conference, nations recognized that aid alone, no matter how well designed, will not solve the problem of global poverty. Real progress requires a combination of efforts in both donor and recipient countries. Developing countries must adopt policies to mobilize domestic resources, reduce corruption, and attract private investment. Industrialized nations must broaden access to their markets, help resolve debt crises and improve stability of global and regional financial structures. Broad-based economic growth, which can only take root in a conducive policy environment, ultimately is the most effective means of reducing poverty and increasing standards of living.

The Broader Framework

10. Because only a limited number of countries will qualify for assistance under the Millennium Challenge Account, it is vital that the new account complement other development programs.

Unfortunately, many of the countries in which poverty is most deeply entrenched and which pose the greatest potential threats to U.S. security will not qualify for assistance under the new account. People will be overlooked in failed states that are unable to provide basic human services, the pariah nations that provide haven for international outlaws, and the authoritarian regimes that engender civil unrest and unleash aggression against their neighbors.

While good governance is essential for sustained economic growth, discrete development programs to build self-sufficiency can be successful in almost any environment. In states where the governments are not effective development partners, assistance can be provided through local civil society groups and international non-governmental organizations. Incipient democratic movements and economic reformers can be strengthened with technical and material assistance. Small businesses and microenterprises can be encouraged through access to credit. By building human capital, such programs empower individuals to meet their own basic needs and lay the groundwork for future growth.

11. Funds from the Millennium Challenge Account must be provided as an addition to, not a substitute for, other development and humanitarian programs.

Increased support should also be directed to existing accounts, including Development Assistance, Child Survival and Health, International Disaster Assistance, Transition Initiatives, Migration and Refugee Assistance, Emergency Refugee and Migration Assistance, and International Organizations and Programs.

Only a small proportion of overall U.S. foreign assistance currently goes to the poorest people and the poorest countries. If the Millennium Development Goals are to be met, then all U.S. development assistance must be increased and sharpen its focus on building prosperity from the bottom up. This means expanding access to education, health care, jobs, technology and credit, as well as broadening democratic participation, combating corruption and promoting equality before the law.

12. There must be strong linkage to humanitarian and refugee assistance efforts.

There is a continuing need to mitigate the number and effects of natural and human-caused disasters, as well as to strengthen the protection of civilians in complex emergencies. A priority must be placed on creating an environment in which refugees and displaced persons return voluntarily to their homes in safety and dignity.

Development does not occur in a vacuum. It cannot be sustained when people are forced to flee their homes due to war, famine or natural disaster. Even in countries where development is on track, extended droughts, floods, earthquakes, and conflicts that spill over from neighboring states can arrest progress. Development assistance cannot replace refugee and disaster aid, nor can it succeed without them.

Americans are a caring and giving people, who consistently support giving life-saving assistance and protection to refugees and displaced people, wherever they may be, and helping them be resettled. Development and humanitarian assistance

need to be more closely aligned. In that way, humanitarian interventions provide a foundation for development and prevent disasters from destroying development gains.

CONCLUSION

Announcing the initiative for a Millennium Challenge Account was a significant first step that has helped to galvanize support for global poverty reduction and focus attention on the Millennium Development Goals. The real test now, however, is designing a program that will meet these goals and ensure that the promised resources materialize. Reaching the MDGs will require the combined efforts of the U.S. and other donor governments, international financial institutions, private businesses and nongovernmental organizations, in developing as well as developed countries.

Over the many years in which InterAction members have carried out humanitarian and development projects around the world, they have learned valuable lessons about what works and why. Although there have been some critiques of development assistance, there have been major successes and breakthroughs already achieved.

With the help of foreign assistance, adult illiteracy in developing countries fell from 47 percent in 1970 to 26 percent in 1998; smallpox was eliminated from the world in 1977; life expectancy in poor countries has risen from 45 to 64; the number of people living below the poverty line has fallen by about 200 million, while the world's population has grown by 1.6 billion; malnutrition has declined by 17 percent over the last decade; maternal deaths were reduced by 12 percent between 1990 and 1995; 55 more democratic governments have been elected over the past 14 years; and just last year, catastrophic famines were averted in Ethiopia and Afghanistan.

Americans can be proud of what their tax dollars have achieved around the world. The Millennium Challenge Account offers a valuable opportunity to put our knowledge and values into action. It can serve to leverage more effective and coherent development overall.

THE MILLENNIUM CHALLENGE ACCOUNT

A LEGISLATIVE PROPOSAL

The attached draft authorization bill is a legislative proposal for the Millennium Challenge Account developed by InterAction and its member organizations as well as other key non-governmental organizations active in international development. The legislation is consistent with InterAction's White Paper on the MCA and benefits from the research and analysis done by many diverse organizations in the development community. It is hoped that this draft legislation can serve as a vehicle for discussions on the MCA between the Administration, Congress and the development community.

The draft legislation represents the consensus of this coalition on the basic principles around which MCA should be organized. This draft is evolving and certain sections are being revised and refined through an ongoing collaborative process. The basic principles include the following:

- The Millennium Challenge Account is one component of U.S. foreign assistance programs and therefore should be authorized under the Foreign Assistance Act of 1971 through amendment of the Act and should be linked to other U.S. assistance programs such as humanitarian, development, and economic assistance.
- Funds appropriated to the MCA must be *in addition to the funds authorized for core humanitarian and development assistance programs* and not a substitute for funding these accounts.
- In order to maintain the link to core development programs and prevent the politicization of this assistance, the MCA should be implemented by a semi-autonomous office in the United States Agency for International Development and should carry new authorities to allow for new, flexible, and innovative mechanisms to improve delivery and effectiveness of assistance.
- The MCA assistance should be directly linked to advancing the Millennium Development Goals (MDGs) and to national efforts to reduce poverty.
- The MCA should support locally conceived and implemented national development strategies such as the Poverty Reduction Strategy Papers. MCA assistance programs for recipient countries should be designed and implemented through consultations with civil society and local governments as well as the national

governments. Proposals for funding should support national development strategies and outline specific development goals consistent with the MDGs.

- The MCA assistance should utilize multiple funding mechanisms including, but not limited to, government to government grants, direct funding of local governments, civil society organizations, and international private voluntary organizations.
- IDA eligibility should be the basic eligibility criterion for MCA assistance.
- To improve the effectiveness of all assistance, the United States must give increased attention to donor coordination and to coherence of trade and economic policies to development objectives.
- The MCA should encourage an emphasis on women both in shaping national development strategies and as the target beneficiaries of development assistance.

This legislation does not identify specific indicators to measure performance under the three areas of eligibility identified by the President, ruling justly, investing in people and economic freedom. The bill, however, does define the principles under each category of criteria which coalition believes should be stressed in determining eligibility. The bill also provides for expanded eligibility to enable countries that may not meet all the eligibility criteria set forth by the Administration to receive assistance under the MCA. The coalition continues to discuss specific indicators and data that should be utilized in determining eligibility and may have more detailed recommendations at a later stage.

MILLENNIUM CHALLENGE ACCOUNT

AUTHORIZATION BILL

10-18-02

AN ACT

To amend the Foreign Assistance Act of 1961 to establish the Millennium Challenge Account for the provision of assistance to certain eligible countries and for other purposes.

SEC. 101. SHORT TITLE.

This Act may be cited as the “Millennium Challenge Account Act of 2002.”

SEC. 102. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) A principal objective of United States foreign assistance programs, as stated in the Foreign Assistance Act of 1961, is the “encouragement and sustained support of the people of developing countries in their efforts to acquire the knowledge and resources essential to development and to build the economic, political, and social institutions which will improve the quality of their lives.”

(2) On March 14, 2002, in a speech at the Inter-American Development Bank, President Bush noted the successes of development: “During our lifetime, per capita income in the poorest countries has nearly doubled. Illiteracy has been cut by one-third, giving more children a chance to learn. Infant mortality has been almost halved, giving more children a chance to live.”

(3) Despite these achievements, there are mounting challenges facing developing countries:

(A) Over 100 million children of primary school age remain out of school, 60 percent of them girls.

(B) 10 million children die every year of preventable causes, 40 percent of them in the first month of life. Malaria alone takes two lives every minute—mainly children under 5 and pregnant women.

(C) Approximately 1.2 billion people live on less than \$1 a day.

(D) 6 million children die of hunger-related causes each year. 800 million people in the world are undernourished.

(E) One woman dies every minute as a result of a lack of access to basic healthcare during pregnancy and childbirth.

(F) HIV/AIDS has claimed more than 22 million lives since the beginning of the epidemic making it the leading cause of death in sub-Saharan Africa and the fourth highest cause of death globally.

(4) Inequalities between men and women undermine development and poverty reduction in fundamental ways. Women’s limited access to resources and

rights—including the right to participate in social and political processes—limits their contribution to family health, education and wellbeing.

(5) The United Nations General Assembly in September 2000 adopted a set of international goals, known as the Millennium Development Goals, calling for the halving of extreme poverty and for substantial improvements in health and education in developing countries by 2015.

(6) In announcing the Millennium Challenge Account, President George W. Bush called for a new compact for global development, defined by new accountability for both rich and poor nations; pledged to increase U.S. development assistance by \$5 billion per year over existing levels by Fiscal Year 2006; and endorsed the Millennium Development Goals, saying: “America supports the international development goals in the UN Millennium Declaration, and believes these goals are a shared responsibility of developed and developing countries.”

(7) The provision of assistance from the Millennium Challenge Account, as defined by President Bush, will be linked to a country’s commitment to ruling justly, investing in people, and adopting economic reforms and policies that make development effective.

(8) The President has called for MCA funds to be provided as an addition to, not a substitute for, other development and humanitarian programs.

(9) To ensure maximum impact, activities under the MCA must be linked to and coordinated with core development, humanitarian, and refugee assistance programs.

(b) SENSE OF CONGRESS.—It is the sense of the Congress that—

(1) The United States should take global leadership in efforts towards meeting the Millennium Development Goals by expanding funds available for such ends, and ensuring that economic and trade policies cohere with the attainment of these goals. In particular, the United States should seek to address the external debt of recipient countries, including debt owed to the United States and other creditors.

(2) The Millennium Challenge Account (MCA) provides an opportunity to build upon the successes and lessons learned over the past fifty years of foreign assistance. To improve the effectiveness of development assistance, the U.S. should support locally conceived and implemented strategies. Programming under the MCA should strengthen civil society and participatory processes, and ensure that those affected play a role in designing and implementing strategies. Development assistance that supports governments and civil society working in tandem will achieve better and more sustainable results.

(3) Effective development assistance requires coordination among donor nations. The U.S. should collaborate fully with developing countries and other donors to support locally developed strategies and to minimize duplication of efforts, competing priorities and burdensome donor requirements.

(4) Development policies, programs, and practices should take into account the differences in the social, cultural, and economic roles of men and women and should ensure women’s full participation.

(5) The President’s pledge of additional funds over three years beginning in fiscal year 2004, leading to a \$5 billion annual increase in development assistance over current levels by fiscal year 2006, is a significant step forward in the fight against global poverty. Assistance under the MCA should be provided at levels and for a duration sufficient to enable a country to make significant progress toward meeting the Millennium Development Goals.

(c) PURPOSES.—The purposes of this Act are—

(1) to enhance the U.S. contribution to achieving the Millennium Development Goals;

(2) to assist men and women in developing countries to acquire the tools needed to lift themselves out of poverty and seize the opportunities of the global economy;

(3) to enable nations to grow and prosper.

SEC. 103. THE MILLENNIUM CHALLENGE ACCOUNT.

Part I of the Foreign Assistance Act of 1961 (22 U.S.C. 2151 et seq.) is amended by adding at the end the following:

CHAPTER 13. MILLENNIUM CHALLENGE ACCOUNT

SECTION 1. STATEMENT OF POLICY.

(a) Congress finds that—

(1) it is in the interest of the United States to support a new compact for global development in which increased development assistance is provided to those

developing countries which have demonstrated a commitment to ruling justly, investing in people, and adopting economic reforms and policies that make development effective;

(2) such a compact should have as its objective, as a shared responsibility between developed and developing countries, the achievement of the goals of the United Nations Millennium Declaration; and

(3) in order to maximize the effectiveness of such a compact, the United States should ensure coherence of economic and trade policies with such goals, including the external debt of recipient countries.

SEC. 2. ELIGIBLE COUNTRIES.

(a) A country shall be eligible for assistance under this chapter if the President has determined, in accordance with section (1) that—

(1) the country is eligible to borrow from the International Development Association.

(2) its government has demonstrated a commitment to democracy and good governance through promoting the human rights of all its people, protecting freedom of association, safeguarding an independent judiciary and media, concerted efforts to combat corruption, transparent budget decision making, and by involving citizens, particularly women, and other disenfranchised segments of society, in the process of making and administering public policy.

(3) its government has demonstrated a commitment to investing in the health and education of its people, with careful attention to the needs of women and girls.

(4) its government has demonstrated a commitment to economic policies that foster sustainable development, poverty reduction, and equitable growth; and that give special weight to promoting economic opportunities for the rural and urban poor—particularly women—to participate in the market economy.

(5) the country is working, in consultation with the International Labor Organization, towards eventual compliance with core labor standards. Countries shall not be obliged to privatize essential services or liberalize capital markets unless it can be shown that this will enhance equitable growth and poverty reduction.

(6) the country has developed a participatory national strategy, such as Poverty Reduction Strategy Papers, for working towards the Millennium Development Goals and otherwise promoting equitable and sustainable development.

(b) EXPANDED ELIGIBILITY.—A country that is not eligible for assistance under the criteria set forth in paragraph (a) of this section, may otherwise receive assistance provided under this chapter if that country—

(1) is eligible to borrow from the International Development Association;

(2) has demonstrated substantial progress towards the criteria set forth in paragraph (a) of this section, particularly criteria pertaining to good governance, accountability and transparency of the budget and investing in people;

(3) has a comprehensive strategy for addressing a particular Millennium Development Goal and is demonstrating commitment to implementing that strategy; and

(4) will use such assistance to improve performance on the criteria set forth in paragraph (a) of this section and to help meet the targets it has established in the strategy called for in paragraph (b)(3) of this section.

SEC. 3. IMPLEMENTATION.

(a) STRUCTURE.—

(1) GOVERNING/POLICY COUNCIL.—The President shall establish a structure for the governance and policy guidance of the MCA which involves collaboration among the heads of the U.S. Agency for International Development, the Department of State, and the Department of the Treasury. These agencies shall ensure coordination with other U.S. government agencies.

(2) ADMINISTRATION.—The MCA shall be administered by a semiautonomous office located in the United States Agency for International Development. That office shall be structured to maximize efficiency, innovation, and responsiveness to partner countries and organizations, to provide appropriate technical and managerial assistance, and to coordinate with other USG agencies and international donors.

(3) DONOR COORDINATION.—MCA activities shall be coordinated with other bilateral and multilateral donor institutions at all stages of implementation, including the review of poverty reduction strategies, proposal submissions, and evaluation of progress. In order to increase complementarity of programs and reduce duplication of efforts for recipient countries, the United States should

work with the other donors to develop common approaches to proposal submission, reporting requirements, data collection and evaluations systems, and other processes for the delivery of development assistance.

(4) **ADVISORY COUNCIL.**—In order to ensure continued input from civil society organizations and transparency of operation, there shall be established an Advisory Council to provide periodic review and advice on the policies and administration of the MCA. This Advisory Council shall be composed of development experts from government and multilateral agencies, academic institutions, non-governmental organizations and other civil society organizations.

(b) **PROVISION OF ASSISTANCE.**—

(1) **PRINCIPLES.**—The approach and delivery mechanisms adopted under the Millennium Challenge Account shall be based on the overarching principles of local ownership, specifically ensuring the use of locally designed national development strategies, and civil society participation. The support for such national strategies will provide a mechanism for assuring coordination with other bilateral and multilateral donors.

(2) **MCA IMPLEMENTATION AGREEMENT.**—Upon a country being determined eligible for MCA assistance and that government indicating a willingness to participate in the program, the USG and that government shall develop an MCA Implementation Agreement to outline the broad areas of collaboration for MCA assistance. Both USG and the recipient government shall have substantial consultations with civil society institutions in the process of developing the MCA Implementation Agreement. This agreement shall be a public document and shall serve as the guide for the submission and evaluation of proposals for funding by both government and civil society institutions.

(A) The MCA Implementation Agreement shall be derived from the country's participatory national development strategy, such as the PRSP, and shall therefore require a joint review of that strategy. This review shall identify areas of desired collaboration, particularly those elements of the country's national development plan for which MCA assistance will be available and shall identify—broadly and not exclusively—the appropriate roles and responsibilities of government and civil society institutions.

(B) The joint review shall identify the strengths and weaknesses of the national strategy in the areas to be funded by the MCA—assessing both the process and the content the strategy—and identify areas for improvement. Particular attention should be focused on the participation of civil society in the development of the strategy and the differences in development opportunities for men and women likely to result from the achievement of goals set forth in the strategy. Technical assistance and funding under the MCA shall be made available for addressing particular weaknesses and other such purposes related to the strategy.

(c) **PROPOSALS FOR FUNDING.**—Proposals for funding consistent with the MCA Implementation Agreement may be submitted by the eligible country government, local civil society organizations, international agencies and U.S. private and voluntary organizations in partnership with indigenous organizations. Proposals should contain the following elements:

- (1) a description of the programs and projects for which assistance is requested;
- (2) specific development goals consistent with the MDGs, targets to be achieved, and measurable indicators of success to determine progress toward these goals;
- (3) a clear indication of the contribution towards and consistency with the MCA Implementation Agreement of the recipient country;
- (4) identification of the key stakeholders and how they will be involved; and
- (5) mechanisms for mid-course corrections.

SEC. 4. REPORTING REQUIREMENTS.

(a) **COMPREHENSIVE STRATEGY.**—Not later than 12 months after the date of enactment the President shall submit to the appropriate congressional committees a comprehensive U.S. strategy, with benchmarks, timetables, and necessary resource requirements for achieving the Millennium Development Goals, through programs of assistance, trade and economic policies, debt relief, and private investment flows.

(b) **ANNUAL REPORT TO THE CONGRESS.**—Not later than December 31 of each year, the President shall prepare and transmit to the appropriate congressional committees a report, which shall be made available to the public, concerning assistance provided to each country under this chapter for the prior fiscal year. Such report shall contain—

- (1) the amounts of assistance provided to each country under this Act;

(2) for each country, the specific goals and objectives of such assistance;
 (c) ADDITIONAL REPORT TO THE CONGRESS.—In every third consecutive year during which a country receives assistance under this chapter, the report in paragraph (b) of this section shall also contain for such country—

(1) progress made toward reaching the goals and objectives set forth in paragraph (b) of this section, including data disaggregated by sex, age, and income;

(2) in cases where progress towards reaching these goals and objectives was hampered by any exogenous shocks to the country's economic, political or social climate, a description of such shocks and their impact on the country's progress towards reaching the goals and objectives set forth in paragraph (b) of this section;

(3) a description of the role of civil society institutions in developing and in achieving the goals and objectives set forth in paragraph (b) of this section;

(4) an overall assessment of progress made toward reaching the Millennium Development Goals, including data disaggregated by sex, age, and income;

(5) efforts towards donor coordination;

(6) the extent to which there is coherence of economic and trade policies of the United States with the goals and objectives set forth in paragraph (b) of this section.

SEC. 5. AUTHORIZATION OF APPROPRIATIONS.

(a) There are authorized to be appropriated to the President to carry out the purposes of this chapter, in addition to funds otherwise available for such purposes, \$1,666,700,000 for FY 2004, \$3,333,300,000 for PY 2005, and \$5,000,000,000 for each of the years FY 2006, FY2007 and FY2008, to remain available until expended.

(1) TERMS OF ASSISTANCE.—Assistance provided under this chapter—

(A) shall be in the form of grants and shall not be repayable, even if provided through multilateral institutions;

(B) shall be made available notwithstanding any other provision of law;

(C) shall be coordinated with other donors utilizing the PRSP and or other national coordinating mechanisms such as national education plans and country coordinating mechanisms of the Global Fund for HIV/AIDS, TB and Malaria, as applicable and to the extent possible, in order to avoid duplication of efforts or contradictory requirements to effectively reach the MDGs; and

(D) may not be used for any military or paramilitary purposes.

(2) LIMITATION.—No assistance authorized by this chapter shall be provided to—

(A) any country that is otherwise ineligible to receive economic assistance under the following provisions of the Foreign Assistance Act of 1961—

(i) section 116 (relating to human rights);

(ii) section 490 (relating to major illicit drug producing and drug transit countries); and

(iii) section 620A (relating to governments supporting international terrorism).

(B) any country whose duly elected head of government is deposed by decree or military coup, until such time as the President determines and certifies to Congress that a democratically elected government has taken office in that country.

(3) ADMINISTRATION EXPENSES.—Of the amounts appropriated each year and made available to carry out the purposes of this chapter, not more than percent of such amount may be used for administrative expenses of the United States government agencies administering programs under this chapter.

SEC. 6. SPECIAL AUTHORITIES.

In addition to the other uses of assistance authorized under this chapter, assistance is authorized to be provided for—

(a) TECHNICAL ASSISTANCE TO MCA ELIGIBLE COUNTRIES.—Technical assistance may be provided to eligible countries for—

(1) addressing weaknesses in its national development plan and in developing proposals pursuant to section 3(b)(2) of this chapter; and

(2) improving the capacity to monitor programs, collect and analyze data, and evaluate program effectiveness, particularly for strengthening the capacity to collect and analyze data disaggregated by sex, age and income.

(b) DEBT RELIEF FOR MCA RECIPIENT COUNTRIES.—

(1) AUTHORITY.—For all countries receiving assistance under this chapter, the President is authorized and encouraged to cancel all amounts owed to the United States as a result of loans made or credits extended prior to

January 1, 2003, under any of the provisions of law specified in subsection (A) of this section.

(A) PROVISIONS OF LAW.—The provisions of law referred to in subsection are the following:

- (i) Sections 221 and 222 of the Foreign Assistance Act.
- (ii) The Arms Export Control Act (22 U.S.C. 2751 et seq.)
- (iii) Section 5(f) of the Commodity Credit Corporation Charter Act, Section 201 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621), or Section 202 of such Act (7 U.S.C. 5622), or predecessor provisions under the Food for Peace Act of 1966.
- (iv) Title I of the Agricultural Trade Development and Assistance Act of 1954 (7 U.S.C. 1701 et seq.).

(B) OTHER DEBT REDUCTION AUTHORITIES.—The authority provided in this section is in addition to any other debt relief authority and does not in any way limit such other authority.

(2) LIMITATION.—A country that is eligible to receive cancellation of debt under this section may receive such cancellation only if the country has agreed—

(A) to direct the financial benefits of debt cancellation to programs to meet the goals and objectives set forth in the MCA Implementation Agreement pursuant to section 3(b)(2) of this chapter; and

(B) to ensure that the financial benefits of debt cancellation are in addition to the government's total spending on poverty reduction for the previous year or the average total of such expenditures for the previous 3 years, whichever is greater.

SEC. 7. GENERAL PROVISIONS.

(a) DEFINITIONS.—

(1) For the purposes of this chapter, the term “Millennium Development Goals” or “MDGs” shall refer to the internationally-agreed goals set forth in Section 102(c) of the Foreign Assistance Act of 1961 as amended by this Act;

(2) For the purposes of this chapter, the term “appropriate congressional committees” means the Committee on Appropriations and the Committee on Foreign Relations of the Senate, and the Committee on Appropriations and the Committee on International Relations of the House of Representatives.

SEC. 104. RELATION TO OTHER DEVELOPMENT ASSISTANCE.

Sec. 102 of the Foreign Assistance Act of 1961 is amended as follows, strike section (c) and insert:

(c) U.S. development assistance policies and programs shall be utilized in support of achievement of the Millennium Development Goals:

- (1) Eradicate extreme poverty and hunger;
- (2) Achieve universal primary education;
- (3) Promote gender equality and empower women;
- (4) Reduce child mortality;
- (5) Improve maternal health;
- (6) Combat HIV/AIDS, malaria, and other diseases;
- (7) Ensure environmental sustainability; and
- (8) Develop a global partnership for development.

(d) To carry out the policies set forth in this section, the U.S. government shall provide assistance to governments and organizations in the form of policy advice, technical and project assistance, financial assistance, debt relief, and commodities:

(1) Development assistance shall be provided to governments and organizations to alleviate poverty and hunger, to enable people and communities to build the capacity to develop economically, socially, and politically, and to strengthen the capacity and commitment of government to govern justly and wisely.

(2) Within development assistance, a Millennium Challenge Account shall be created to provide assistance to help implement indigenously designed national development plans for countries which demonstrate a strong commitment to, and are taking concrete steps toward, good governance, open economic systems, and investing in their citizens.

The CHAIRMAN. Dr. Berresford.

**STATEMENT OF SUSAN BERRESFORD, PRESIDENT, FORD
FOUNDATION, NEW YORK CITY, NY**

Ms. BERRESFORD. Good morning. It is a great honor to be here today and a personal pleasure, I would say, Mr. Chairman, to be here before you, knowing of your enthusiasm for the Ford Foundation's International Fellowship Program and your assistance with that.

The MCA is a very welcome initiative from the administration. It is bringing substantial new resources and new ideas to the development field.

I will focus primarily on ways that the Ford Foundation's international development assistance experience may contribute to your thinking about the structure and operation of the new Millennium Challenge Corporation.

Ford is a private foundation with more than 50 years of work internationally in development in this country and overseas. In that period we have provided more than \$12 billion in grants and loans, about 40 percent of that overseas. And while \$12 billion is a lot of money and a big number, it is very small in relation to the development need.

And so we have thought of ourselves, really, as an R&D donor, or a venture philanthropist, testing new ideas, trying to bring them to scale, building new kinds of institutions, and trying to amplify the voice and contributions of talented people who would otherwise be marginalized in their societies.

We are headquartered in New York City, and we currently have 13 offices in Africa, Asia, Latin America, and Russia. We work in 35 countries through these offices, and about 46 percent of our spending in program goes overseas.

You have asked me to testify specifically on such issues as the optimal ratio of funding levels to staff, the ideal composition of a foundation board, and the advantages and disadvantages of field offices. And while the Ford Foundation's structure and scale is quite different from that that is being proposed here, I think there are some principles that perhaps I can offer. And I have four to offer today that may be useful in thinking about the new corporation.

Principle No. 1 is to work close to the ground through in-country offices. We believe strongly at the Ford Foundation that our offices overseas make us particularly effective in supporting development on the ground—and it is on the ground where development really occurs.

In-country offices allow us to be genuine partners with the development players who are working doing the hard daily work. They give us a local credibility, a seat at the table with people who are wrestling with the serious problems of development. They give us a full and nuanced sense of country and culture and context. And they allow us to understand how things really are working as they are rolling out on the ground through grants and loans.

They help us also make well informed decisions about initial funding, understanding the difference between something that looks good on paper but in reality is not quite so promising, or even vice versa.

And they give us the very critical ability—and we have heard a lot about this this morning—to ensure very strong evaluation and monitoring that gets at what is really happening.

I think the MCC needs these capabilities very clearly, and I do not think there is any other way to get them than having some kind of presence on the ground.

And, of course, there is a disadvantage to having a presence on the ground, it costs more money than staying in one place outside. We have accepted that increased cost because we believe it so greatly increases our effectiveness. And in our experience and our scale of operation, an overseas office brings an additional 15 percent cost to the amount of money that you are moving into a country.

Principle No. 2, invest in staff with diverse qualifications and give them significant authority and flexibility. And this is really a corollary of the first point.

Our board gives the president of the Ford Foundation authority to approve all grants and loans, after substantive discussion with the board about the aims of the programs that we undertake, the means that we are likely to take, our strategies, the amount of money, and how we are going to be measuring progress.

With the board's approval, I delegate further down to the overseas offices very significant authority to make decisions. This helps us not get bogged down in bureaucracy and very time-consuming endless processes.

Obviously, our staff regularly report back to the board on progress and how things are going. And we require regular reports from our grantees.

For decentralization of this kind to be effective, we require seasoned people who can handle this degree of authority and responsibility, and a very streamlined approval process. We recruit staff with excellent academic and know-how, knowledge of in-country context, and language.

They are economists, lawyers, doctors, social scientists, NGO leaders—a diversity that we have found very fruitful to development work, because you need to bring so many different kinds of players into the development process. Thirty percent of our staff are drawn from the countries in which we work.

And I might note, similar to the proposed Millennium Challenge Corporation, our grant makers work on fixed term contracts, generally 3-year contracts. We hope they stay for two contracts in their overseas assignments, so a total of 6 years.

Now, the ratios. Across the foundation, we have 125 grantmakers, 65 of whom work overseas, outside the United States. On average, each of these grantmakers handles a grant budget of about \$3 million a year. That could rise to \$5 million perfectly easily.

And because our grants are for multiple years, grantmakers typically manage an active portfolio of about \$7.5 million. We expect our grantmakers to be active in the work that they are doing, to be visiting grantees regularly, to be convening meetings of people doing like work in other parts of the world or in the region so that our grantees are exposed to the very best thinking that is avail-

able. And we expect our staff to help them muster the kind of professional expertise they would need to solve problems that emerge.

Reflecting on this, in Ford's experience and even allowing for the differences in scale that I referred to earlier, I find the proposed MCC staff total of 100 persons surprisingly small for an entity that is likely to be spending \$1.3 and up to \$5 billion a year. So I think that may need some further thought.

The third principle is that we should all be aiming to build local development capacity in all three sectors over the long term. The responsibility for national development lies with a country's own people and institutions. And every development donor ought to be engaging very directly with the people and institutions in all three sectors—government, business and non-profits—and I think particularly with the nonprofit, voluntary sector now, which has become such a flourishing force for good and for development in many countries in which we work.

The plans for the MCC seem sharply focused on the government—as they are now written—as the primary development leader and contractor. And certainly, government has a lead responsibility. But innovation and effectiveness also is found outside of government, for example, in the NGO community.

And, therefore, it seems to me it might sense for the MCC to state clearly its aims and objectives in a country and then have an open competition where members of all sectors might apply and bring forward their best ideas, and some may even come in combinations across sector.

No single sector has a monopoly on good ideas and, in fact, some of the most innovative development advances have come from cross-sectoral combinations.

And I do not have this in my written testimony, Mr. Chairman, but I also would observe that in many countries in which MCC is likely to operate, the relationship between governments and NGOs is not entirely settled and not always totally comfortable. And so I am not convinced that relying entirely on government as the key contractor would bring forth the very best of NGO participation.

I would make a related point about evaluation and monitoring. In many countries in which the Ford Foundation works, there have been built up over the last decade or two very significant capacities in country universities, in think tanks and policy analysis groups that can do very sophisticated monitoring and tracking and evaluation of programs, national and local.

I think the MCA has an opportunity to build on this and strengthen these capacities, and at the end of the day, it is these local analysts of development and progress that need to be very strong in every country. And so it seems to me as the proposal now reads, it may be overly dependent on evaluation from outside the country, and perhaps more emphasis could be given to engaging the analytic capacities that are there within region or within country.

The last principle I would stress is that it is important to get guidance from a diverse and active board. The Ford Foundation's trustees have always included corporate CEOs, former elected and appointed government officials, and NGO and civic leaders. They come from the U.S. and they come from overseas. We need that di-

versity because of the variety of sectors in which we work in the development process.

They also help us with donor coordination and collaboration, and that is obviously a challenge in this new entity as well.

Most important is that our trustees are outsiders, in a sense, to the Ford Foundation. They come in from the outside. And they bring us the most up-to-date knowledge of activity in each of their spheres, and they challenge our assumptions and our ideas. And that is very important in an institution that is involved in the hard daily grind of development work.

The board for the new entity for MCA will obviously reflect the fact that it is a program of government assistance. But I think it is worthwhile for the Congress to consider ways to draw upon the strengths of individuals beyond the public sector and perhaps even drawing people from some of the countries that are likely to be involved in the programs.

Finally, I would say that MCA has a very laudable goal of making assistance for development more transparent and less subject to political pressure than it has been in the past. That is a challenge both in perception and in practice.

And I think an active and diverse board with outsiders could be an asset to the new entity in bringing this special kind of credibility.

That concludes my testimony, Mr. Chairman. I would be happy to answer questions.

The CHAIRMAN. Thank you very much, Ms. Berresford.
[The prepared statement of Ms. Berresford follows:]

PREPARED STATEMENT OF SUSAN V. BERRESFORD, PRESIDENT, FORD FOUNDATION

Good morning. I am Susan Berresford, President of the Ford Foundation. It is an honor to testify before this committee on the Millennium Challenge Account and the proposed Millennium Challenge Corporation. I might say, Mr. Chairman, that it is a personal pleasure to be here, knowing of your support for the Ford Foundation's new 10-year International Fellowship Program and your long and distinguished record of leadership on critical issues in U.S. foreign policy.

The MCA is a very welcome initiative from the Administration. It holds the promise of bringing substantial new resources to U.S. foreign assistance for development. It also has the potential more fully to express our country's responsibilities—and our values—to help those least favored in our world. Equally important, MCA shows fresh thinking both about how development occurs and how this country might better assist others in their own efforts. Development is a large, multidimensional process. This is wisely recognized in the legislation's focus on just and democratic governance, economic freedom, and investment in people. Development must draw upon and energize the full range of a country's people and institutions. That is the Ford Foundation's experience and, I believe, reflects the best thinking in this field.

At this point the new entity that will oversee and administer the MCA is still to be structured and fleshed out. Of utmost importance is clarifying the MCA's relationship to other existing agencies of official foreign assistance, perhaps most fundamentally USAID. Since I believe others are commenting on this crucial point, I will focus primarily on ways that the Ford Foundation's international development experience may contribute to your thinking about the structure and operation of the Millennium Challenge Corporation.

The Ford Foundation is a private foundation with more than 50 years of work internationally and in the U.S. In that period we have provided more than \$12 billion in grants and loans, about 40% of that abroad. Those are significant dollars but only a small part of the total resources needed for development. Recognizing the limitations of this scale of funding, we have tried to function as an "R & D" donor—using our resources to test new ideas and help bring them to scale, to establish new kinds of organizations, and to amplify the voice and contributions of talented people who would otherwise be marginalized. We seek to be a resource for innovative peo-

ple and institutions strengthening democratic values, reducing poverty and injustice, promoting international cooperation, and advancing human achievement.

A fundamental challenge facing every society is to create political, economic and social systems that promote peace, human welfare and the sustainability of the environment on which our lives depend. We believe that the best way to meet this challenge is to encourage initiative by those living and working closest to where problems are located; to promote collaboration among the nonprofit, government and business sectors; and to ensure participation by men and women from diverse communities and at all levels of society. In our experience, those activities help build common understanding, enhance excellence, and enable people to improve their lives and communities.

The Foundation is headquartered in New York City, and we currently have 13 offices in Asia, Africa, Latin America and Russia. Through this network, we support work in some 35 countries. About 46% of our current program budget is spent on international development.

In your letter inviting me to testify, Mr. Chairman, you asked that I focus my comments on the obstacles that the new Millennium Challenge Corporation may run up against. You mentioned such issues as the optimal ratio of funding levels to staff, the ideal composition of the foundation board, and the advantages and disadvantages of field offices. As you noted in your letter, the MCA does have some similarities to foundations such as Ford in its character and purpose. There are also obvious differences. For starters, the scope of MCA—a contemplated \$5 billion annual spending level by its third year of operation—dwarfs even the largest private philanthropies. And as an initiative of the United States government, it will operate somewhat differently from an independent, private foundation.

But there may be principles of operation from Ford's experience that would be helpful guideposts for MCA. I will try to put four of these before you for this committee's consideration.

(1) *Work close to the ground through in-country offices.* We believe strongly that our structure of overseas offices makes Ford particularly effective in supporting development on the ground—which is where it has to take place. In-country offices allow us to operate as genuine partners—building relationships of mutual knowledge and respect with people and institutions in country. They give us local credibility—a “seat at the table” with others who are tackling tough issues in development. They allow a full and nuanced sense of context and culture, of how things really work and how they are evolving as the grants and loans play out. Moreover, since we are local, we can respond quickly to new opportunities and unforeseen difficulties that are hard to see from farther away. They help us make well-informed initial decisions about funding—the difference between a project that looks wonderful on paper but less promising on the ground or vice versa—and they are critical to our ability to ensure reliable monitoring and evaluation. The MCC needs these capacities that are nearly impossible to obtain any other way.

Of course, maintaining overseas offices has a cost, and that is something we have accepted in order to increase effectiveness. In our experience, at our scale of operation, an overseas office brings an additional cost of 15% of the funds spent overseas.

(2) *Invest in staff with diverse qualifications and give them significant authority and flexibility.* This follows on very closely from Ford's commitment to working close to the ground in an R&D mode. Our board gives the president authority to approve all grants and loans, after substantive discussion between the board and staff about the aims, strategies and funds we expect to employ, and how we will measure progress. And with the board's approval, the President further delegates much grantmaking authority to heads of overseas offices. This is to avoid decisions being bogged down in endless process and bureaucracy. Staff regularly report back to our board on how the work is going. We also require regular reports from grantees and have normal accounting and other controls.

For such decentralization to be effective, Ford needs seasoned people able to handle that authority and a fairly streamlined approval process. With this in mind, we recruit an overseas staff with excellent technical and academic skills, knowledge of the country context, and local languages. They have a range of professional backgrounds—they are economists, lawyers, MBAs, social scientists, NGO leaders—a diversity that we have found contributes to fruitful thinking across the different dimensions of development. Many are drawn from the countries or regions where they are working—30% of our program staff, currently—bringing perspectives that help us formulate more informed judgments and strategies. We look for people able to interact effectively with local men and women at all levels, and with experience in complex organizations. I might note that all our program staff operate on 3 year

contracts. They typically spend about 6 years with the foundation. We benefit enormously from fresh thinking that new staff members bring to our different programs.

Across the foundation we have 125 grantmakers, 65 of whom work outside the U.S. On average each overseas staffer now makes grants totaling \$3 million per year. If our assets grow, these totals could increase to \$5 million. As most of our grants are for two to four years, each staff person manages a portfolio of old and new grants totaling about \$7.5 million. Portfolio management includes visiting grantees, helping grantees to muster useful expertise, and convening worldwide and national meetings to exchange ideas with people doing similar work. In each overseas office, in addition to grantmakers, we also have accountants, and normal office staffing to help ensure compliance with relevant laws and adherence with good practice.

Reflecting on our experience and even allowing for differences in operating style and purpose, I find the proposed MCC staff total of 100 persons (covering grantors, back office and other functions) surprisingly small for the \$1.3 to \$5 billion spending levels contemplated in the first years.

(3) *Aim to build local development capacity in all three sectors over the long term.* The responsibility for national development lies with a country's own people and institutions. Thus, development donors should engage with a country in ways that build individual and institutional capacities in all three sectors—government, business and non-profits. Although Ford is an R&D donor and does not fund "country plans" as such, we do have experience with all three sectors. Our way of working with each of them has varied in different times and country settings, depending on where we see ideas, energy, and need. Sometimes we have focused primarily on working with government agencies and infrastructural institutions, sometimes with business, other times with NGOs and civil society. Local and national NGOs have become a flourishing force for development in many of the countries in which we work. We devote significant resources to helping build their capacity, in addition to working with U.S.-based international NGOs.

Plans for the MCA seem sharply focused on the government as the primary development leader and contractor. Certainly, government has a lead responsibility but innovation and effectiveness are also often found outside of government, for example in a country's NGO community. It may make sense for the MCA to state clearly its aims and objectives in a country and then have an open competition that allows all sectors to bring forth their best proposals, and some to apply in cross-sectoral combinations. No single sector has a monopoly of good ideas, and often the most fruitful development innovation involves combining the capacities of at least two of the three sectors.

I would make a related point about evaluation and monitoring. In many countries in which the Ford Foundation works, universities and policy analysis groups have been building capacity for evaluation and tracking of national and local programs. Some NGOs have also built very sophisticated systems for monitoring and analyzing their work and that of counterparts. In the long term, these independent analytic resources are essential to ongoing development. The MCA has an opportunity to utilize and further strengthen them. As it currently reads, the MCA proposal seems overly dependent on evaluation from outside, presumably from U.S. based institutions. Each MCA grantee could be encouraged to include in its proposal a full plan for evaluation and monitoring, utilizing its choice of independent institutions that meet certain specifications and qualifications. MCA could still have its own overview review process, but it can augment this with the observations and analysis of professional people close to the ground and familiar with the operating realities.

(4) *Get guidance from a diverse and active board.* The Ford Foundation has an independent board drawn from all three sectors with which we work. Our trustees have always included corporate CEOs, former elected and appointed government officials, NGO and civic leaders. They come from the U.S. and from countries around the world. We need that diversity because our program strategies involve civil society, government and business and encompass a wide range of fields related to social change and development. Our trustees are particularly valuable in bringing us the most up to date experience of individuals who are active in their different spheres. They view our work with "outside" perspectives, and they challenge our ideas and our assumptions—playing a very useful role in an institution deeply engaged in daily realities of development. Our trustees devote approximately 15 days to the foundation every year—in three two-day meetings in New York, in a field visit of 3-7 days to look at our programs and initiatives in the U.S. and abroad, and in various consultations and preparation.

The board for the new entity for the MCA will obviously reflect the fact that MCA is a program of government assistance. But it is worthwhile for the Congress to consider ways it could draw upon the strengths of individuals beyond the public sector.

MCA is not a conventional government-to-government aid program. It will support development involving a variety of organizations from civil society and from the private sector. It would benefit from guidance from a board whose members were active in those different spheres, which have complementary contributions to make to overall development. And it would be stronger if it included active participation of individuals from countries in the developing world itself.

The MCA has a laudable goal of making assistance for development more transparent and objectively-based—and less subject to political pressures familiar in past programs. That is a challenge in both perception and practice. An active, diverse board could be an asset to the new entity in establishing its credibility as a fresh approach to U.S. developmental assistance. Even more important, such a board could also give MCA the kind of guidance it will need if it is to be a pioneer and respond to and support the full range of ideas and energies that go into genuine and lasting development.

Mr. Chairman, that concludes my testimony. I would be happy to respond to any questions the Committee may have.

The CHAIRMAN. Let me start the questioning, and we will set a time limit of 10 minutes each round, and then I will call on Senator Nelson for brief comments and discussion.

First of all I want to test out the indicators. Dr. Radelet, I think there is merit in your suggestion that the indicators have an absolute aspect. If they are constantly shifting around medians by definition—and one of our questions earlier was trying to get at this, I suppose—half or above or half or below, ultimately the qualities that are being sought by our government as I understand this may become more diffuse.

Of course, it could be everybody that rises and you would say then that some of the early winners drop off the charts somewhere midway in their development program.

But in the case, for instance, of governmental corruption, how do you get absolute indicators? Do you say either you have a government that is not corrupt or one that is? In a way, this almost invites a relative standard.

Some governments appear to be more corrupt and others less so. Some of the indicators, obviously, and some you suggested, permit a more statistical precision, but what do you advise as we get into the indicator business?

Dr. RADELET. I think that several of the indicators can be moved into absolute scales immediately—immunization rates, expenditure on education and health, and primary completion rate, several other things—obviously inflation, budget deficits. But there are several corruption rules of law and others that are much subjective as they are measured now, and those could not be moved to an absolute standard right away.

There are some research efforts underway to investigate ways that those indices could be made more objective, to look at court cases, to look at payoffs and bribes, to look at various other indicators of corruption, to look at court cases and those kinds of things. But those are, I think, in their infancy, and it will take several years to develop those.

Hopefully, this program will support efforts to improve the range of indicators, not just in terms of subjectivity, objectivity, but also to incorporate other kinds of things that we might like to look at that—where data are not there yet.

So there are these efforts that are underway to begin to make these more objective indicators and we should—we should be sup-

porting that. But you cannot move to complete objective indicators right away.

The CHAIRMAN. I understand your testimony is that the indicators ought not to be in the legislation, even though 16 have been identified. Now you are suggesting maybe additional ones should be added—that this should be at the discretion, perhaps, of this board, that it keeps thinking through the program and what the objectives of our government are, vis-à-vis other governments. Therefore the board has the flexibility to add and subtract here without appearing to be arbitrary so that the nations involved at least feel the competition is fair, that we are not changing the goal posts.

Dr. RADELET. Well, I think that is right. I think there are ways to improve it. And I think the ways to hold the administration accountable are to make sure that it is transparent, open and public, so that people can test those so that there is a clear relationship to poverty reduction, to economic growth, and to other development goals. And as I said, that they report regularly to you as to the rationale behind any changes in the selection process that they use.

The CHAIRMAN. I wanted to touch on—all three of you have touched upon this very important issue of the fact that the proposal that we have now really relies very much upon government to government relations. In other words, the thought is that governments are responsible to be clean and not corrupt, and governments are responsible for educational standards and various other things.

But as you are all pointing out, there—from your experience, NGO's and businesses—to name two entities—within the decision-making process in a country are often very important in terms of development. And it is not clear, at least as I look at the draft legislation, how that is contemplated currently. And so this is something that probably requires some thoughtful integration in our own thinking here.

However, some of you have pointed out that NGOs may sometimes be at variance with the governments. And, therefore, relying upon the government to dispense the funds is a friction situation to begin with, or vice versa, sending money directly to the NGO.

Now, you point out, Ms. Berresford, from your work with the Ford Foundation, in order to get the NGO situation there active, you have a lot of offices on the ground, you have a lot of people on the ground. You stressed your on-the-ground business in many ways.

Obviously the spartan proposal that has been presented today of 100 employees does not contemplate very many people on the ground.

Now, as we heard in the previous discussion, USAID, as I suspect, is supposed to provide most of the people that are on the ground, although that requires a lot of thinking through as to how they do that, how the governance works.

What I perceive is that the administration faces a problem with regard to perception, a public relations problem on foreign aid. Namely, for a long time people have had an adverse view of it. This is one reason it does not grow very much; in fact, it has been contracting in most terms of the humanitarian or economic development character.

So to resurrect the idea, a new idea of criteria of countries that do good things, namely for children, for women, to combat corruption and so forth, we need a mechanism to determine who are going to be the winners. We need to establish incentives, so that then we celebrate countries that are successful and becoming more successful through our assistance, countries which already have been very poor by the criteria of \$1,400 and some or less, but which have a chance to make a big difference.

Now, in doing that, however, the administration also knows from a public relations standpoint that creating another bureaucracy has some down sides, namely, that people feel that governmental bureaucracies are too big, that we already have several, and that we are about to create another one.

So they have tried very hard not to create another one. The 100 people probably stay here in Washington, looking at the criteria, measuring the countries, making decisions on policy. Whereas somebody else is still in the field. Once again, who and how do they relate?

In our hearing the other day on world hunger, we had testimony from knowledgeable people from the NGO community that most of the effective work was—hunger or the HIV/AIDS question which intersects in the African countries in particular—has come from on-the-ground work from very skillful NGOs. This is not a settled question as to how people can be effective in any country, even if the country has a fairly effective government and it meets this criteria.

And the actual measurement of the results in terms of malnutrition or HIV/AIDS seems to be much more complex as to how people come into the programs and interact. So that implies a lot of people, and this is the reason I am raising the question of you. We raised it of the others and we will raise it some more, because the administration has a draft bill which we will either accept or have to modify in working with our House colleagues.

So it is important that this get started right, the governance structure. I am still sort of groping. If you were to pick up things where they are now, should we be managing this through USAID, or is that politically impossible?

People say that USAID simply does not have the popularity, the credibility, or whatever. It has sort of lost its luster. Even though we need all the manpower, all the foot soldiers that are there, we need something else to be the spear carrier of this. How do we do that?

I will ask each of you to make some further comments. You have already been generous in your testimony, but I have tried to draw a finer point, if I could.

Dr. Berresford, would you testify?

Ms. BERRESFORD. I think—the first point I would make is that the public perception problem will be helped, I believe, somewhat by having criteria for inclusion and measurement of progress and benchmarks and all that.

But I also think the public perceives some of the governmental entities that do development as not being able to move fast in responding to new developments or adjusting as things go along. And

so there is an efficiency question too that, I think, that has to be addressed in a public way.

Our experience working with AID in the various countries in which we work is that they have very good on-the-ground knowledge. They are very good partners for us. There—they know what is going on. They are helpful, thoughtful. So it seems to me this question of the relationship of this to AID has to be sorted out very clearly, and it is not clear yet.

If on the other hand, the proposal goes in this other direction of creating a separate corporation, something like a foundation as is suggested, and does not really coordinate closely with or incorporate AID, I do not think you can do it on the cheap. I think the mistake would be to think that because you put in benchmarks and clear measures and set out objectives that you can do this a different way. And that really is not the case.

If you think about development in our country, we try and reform our school systems, something that these countries are going to be trying to do. There is no magic to doing that. It takes time. It takes investments of people. It takes people close to the problem to know what is going on.

Just having contracts and benchmarks does not get you there.

The CHAIRMAN. Yes. You are suggesting, in other words, an additional 15 percent that you found in your own organization was required on top of the grants—

Ms. BERRESFORD. Right.

The CHAIRMAN [continuing]. To have the on-the-ground, and to have the administration—

Ms. BERRESFORD. And be able to make—understand what is going on and then make the convincing case to the public that something is actually happening.

With your indulgence, Senator Nelson, may I ask the other two to comment?

Senator NELSON. Absolutely.

The CHAIRMAN. Thank you.

Ms. MCCLYMONT. Thank you, Senator. With respect to the public perception, Senator, we have done some polling recently, which suggests to us that, indeed, the American people are very concerned about waste and ill spent money. But at the same time, they very much support a lot of what the MCA and frankly a lot of what USAID—the USAID does in terms of very concrete development goals, helping mothers and children, and getting clean water, and fighting hunger, and fighting poverty. These are very resonant concerns.

So I hope that with the MCA, it will not only be the opportunity to feature another way of doing business, but it will also give the opportunity to talk more broadly about the importance of this development assistance we give overseas through the leadership of the President, and certainly of your committee, Senator, and the Congress more broadly.

With respect to some of your points about civil society and NGOs, we believe the administration has alluded to these concepts, but we think they need to be more pronounced. We suggest that there be an implementation agreement with a government indeed, but that that implementation agreement or contract, if you will, is put to-

gether through full consultation with civil society and private sector and others so that there is a real voice being given and concern being given from those entities.

This is done, Senator, as you well know, oftentimes in a country through the so-called national development strategies, which already exist, which may be able to be built upon to get to these more specific projects that are needed. And then indeed in terms of the implementation, we would offer that this broad contract with the government which is put together in that fashion then be implemented through specific proposals that are consistent with that contracts that are put forward by civil society and others.

And those could be put forward to either USAID or this new MCC. So that would give the protection of the national government, not necessarily working directly with the civil society groups, but that would manifest in another way.

I guess the final point I would make is that we really do believe that given the extensive presence of USAID on the ground. And when we looked at the countries that Mr. Radelet had actually reviewed, if you were going to use him as an example, in virtually all of them there was a USAID office.

So those entities with all of that experience could be working very closely with the national government to get the job done rather than creating a whole other presence such as the MCC, so we do stress that there are ways to do that.

And, again, if the Congress does not go with that route, we think that still there should be an extensive reliance on USAID and a real coherent strategy put together to bring them together.

The CHAIRMAN. Thank you very much.

Dr. Radelet.

Dr. RADELET. Senator, just a few points. I think it is important to have broader participation than just the recipient government in terms of coming up with ideas and writing proposals that will require more staff and more work, but it will also lead to more proposals, more innovative ideas. And, yes, there is some tension sometimes between NGOs and governments, but sometimes that is a healthy tension. And I think it would be a mistake to run everything through the government and squash some of the innovation and some of the independence from NGOs and other private entities.

So I think there needs to be a way to open it up to have some limited capacity for others to write proposals directly to the MCC for funding. The recipient governments could review it and comment, but I don't think they should have the authority to necessarily reject those kinds of things.

A second point, I think 100 people is too small to run this thing. Yes, we do have the perception of poor aid, but we could add to that if we have a new organization that does not have the staff to do what it needs to do that is not coordinated with our other things that is redundant in some ways. And that could actually end up worsening perceptions.

We need to have enough people to make this work effectively. And I really do not see how you can do this with 100 people once you start thinking about the number of people needed to just look at the indicators, to look at what is working in other aid agencies,

to know what is going on in development economics, to be aware of what is going on on the ground, to be thinking about the next tier of countries, not to mention personnel and finance and staffing and all the other kinds of things that you need to make an organization work. So I do think that there is a danger that this is too small.

I do have some concerns about relying on USAID staff on the ground, because they would be two separate institutions. And I think that could create some problems of communication and some rivalries if we have the MCA staff here in Washington relying on a separate agency on the ground. So I do think you would have to have MCA staff on the ground, but more broadly, I think the idea of implementing this program through USAID needs to be considered again.

Ms. McClymont mentioned it in, you could have the criteria, you could have the new ways of implementing programs, but it could come under the direction of the person who is already appointed to be the President's advisor on development assistance and therefore coordinated with the other programs on the ground.

I think there are ways that you can take the best features of the administration's proposal, but bring it into AID and make it separate the way that the Customs Department is separate—well, it was separate from Treasury or the IRS was separate; that they answer to the same person but they were really independent entities that help coordination in the same way.

The CHAIRMAN. Thank you very much.

Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman. Doctor, how are your criteria for a selection of a country different from the administration's?

Dr. RADELET. They are the exact same ones. I took their procedure, identical procedure, their 16 indicators are all public, with one exception actually. Their budget deficit data, they use a confidential IMF data source, so I used publicly available budget deficit data. But otherwise I followed it to the tee and took advantage of their strong proposal to make this open and transparent and just use it with data available today.

Now, the data will change. These data are revised regularly; and as I mentioned earlier, five of the sixteen indicators are going to be revised in the next couple of weeks, and so the list will change. So I think there are good reasons why the administration has not come out with its list. But my procedure is identical to theirs.

Senator NELSON. What about a country like Mozambique? Would it qualify?

Dr. RADELET. The first time I did this run back in December, they did not qualify, but new data on immunization has come out in the last couple of months and now they do qualify. That was a standard that they had missed before, and they make it now. So according to the data available today, by my calculations, they would be on the list.

Senator NELSON. Mr. Chairman, other than straight discussion of foreign aid, when we start talking about food aid how would this criteria be employed in the qualification of someone being eligible for food aid? And I think, you know, of the obvious one right now,

North Korea, I think 20 years ago where the famine was and still is again 20 years later, Ethiopia. Only it was a Communist government back then—how would that all fit together?

The CHAIRMAN. Well, the administration testified earlier that there are broad humanitarian programs. Food, HIV/AIDS were named, these will continue on. USAID has a mission—or other agencies do—to deal with these.

This is going to be a very special niche for select countries that are doing the right things. That will be an extra impetus for economic development, but it will be segregated off from broad humanitarian goals.

Senator NELSON. Thank you.

The CHAIRMAN. Thank you very much, Senator Nelson. Let me ask just as a general question, because I—the administration—I did not get into this, and I am not quite clear as you. And they have discussed the fact that some of these programs may have several years of duration. A country comes on the list, let us say, in this initial listing—and I think as has been pointed out—even with 7 percent real growth, using the rule of 72 or what have you, it takes a long while to double or triple whatever you have got.

Is this program likely to last a long while? In other words, as I try to think through the practical aspects that we face here in the Congress with programs that have some legs to them, we are going to authorize perhaps a new entity here, the MCA, and we will have an initial selection round, probably with some enthusiasm.

But each year, as I gather our procedure, the appropriation committees will have to appropriate money to fund this if it is to go from the \$1 billion level to the \$5 billion or whatever is contemplated. And let us say a country gets started on a program that has five or 6 years, maybe even a 10-year span, what is the confidence level that we are going to be able to give to the recipients?

Now, this may be beyond your reckoning or mine. Life goes on in this democracy. Members come and go, as do administrations. But I am just trying to think sort of in advance.

For the Ford Foundation, you have an endowment, and if it is well invested, it will not disappear from year to year. It is there, and you have a certain amount of money to spend. And so does our government really, although the competition for resources in appropriation remains in a political society here.

Have any of you given any thought to this, or have you visited with the administration people and raised that question outside of this hearing?

Ms. McClymont. Well, Senator, first of all, I do think it is anticipated that the MCA would come into place and be in place and that the \$5 billion would be present going forward. We know how difficult the resources question is.

I think that it is very important though to underscore that although it would be critical to find the resources to do the MCA program, to do this important experimentation, it will also be important to recognize that we must not diminish the current core development assistance programs that are there now.

Senator Nelson alludes to the food aid question, which, of course, would not be really covered by this as you have said. So I think it is notable that, for example, in the 2004 request that the Presi-

dent has made, in fact, the funding for USAID has not been increased. And some of the core development assistance accounts, the Child's Survival and Disease accounts have, in fact, decreased through the request.

So I think it is something that we are going to have to really watch very closely to ensure that the resources are available for both the programs.

The CHAIRMAN. Yes, Dr. Radelet.

Dr. RADELET. There is a couple of dimensions to your question. One is the length of an immediate program or proposal or contract as the administration has proposed. The second is then the renewal of that contract over a longer period of time.

On the first issue, the administration is talking about a contract length of 3 to 4 years, and they are trying to balance that between giving countries enough commitment over several years to—and recognizing that programs do take time on the one hand. On the other hand, recognizing that things can change as well on the ground and that we need every once in a while to review. So they are settling into that length of a contract, which makes reasonable sense to me.

Once a country qualifies, they would negotiate a proposal. And as long as they meet all the benchmarks along the way, they would not need to requalify. As long as they are performing along the way and funds can be dispersed over that 3- or 4-year period, then they could try to requalify. And as long as they are in good standing and things went well, there could be a follow-on contract.

That system generally makes sense to me, but over the longer term, the idea that we can have one or two contracts and then pull out, I think, would really undermine the objectives and lead to greater resentment and really create problems for us.

If we hold this out and promise that if countries do well that we will support their efforts to reduce poverty and sustain development. And then when countries actually do this, if we then begin to cut back funding and reduce it in other ways, I think that is going to hurt our credibility and really undercut achieving our objectives in the long run.

So we are making a longer term commitment here if we are going to do this and do it well.

The CHAIRMAN. Do you have a comment?

Ms. BERRESFORD. I would only add that I think the more you introduce the use of benchmarks as strict measures, the more you introduce a short-term timeframe into the way that people think about programs. And we know that development takes a very long time, and so success in stage one of meeting a benchmark is probably not going to mean success all the way to the finish line where a country wants to get with its education system or its health system. So that ensuring the future of a long-term fund there seems to me very, very important.

The CHAIRMAN. Well, I think so, and this is why I am a little concerned about how we start out that trail, recognizing under our system of laws that we do not have a way exactly of ensuring the continuity of this situation.

For example, in the humanitarian programs, world famine rises and falls, although there are some countries that we know have

really systemic problems, sometimes of government, quite apart from crops and weather.

Or we are about to get into the HIV/AIDS question in a much larger way. The President has made dramatic proposals and most optimists about this would say this is a problem that is going to be with us for quite a long while. So there are some situations that, because they are of a humanitarian character or maybe even because of a political relations change—if we are giving aid to a country for strategic reasons and suddenly the country decides to join some other alliance and jump away from us—well, then we have the ability to say, “OK. Well, that is the way it goes.” I mean, you sort of look at your new patron.

But now here in a business-like way, we are talking about criteria, of performance, and suggesting development of a long-term character for countries that start at a very low level of per capita income and have a long way to go any way you look at it. This strikes me as a different kind of program than we have had before.

We have been struggling with who administers it on the ground and even who governs it here on the board. These are important questions. But just the overall concept of this thing, how do we phrase this? Do we have a preamble or do we have some general ideas that we want to make a part of this authorization?

It seems to me to be very important so that we characterize in ways that our successors in this committee or in the Senate, what have you, recognize where we started, what our thoughts were at the outset. So this is not something we can decide among the four of us right now, but I invite your continuing thought about this.

We are in the drafting process of something that may have some legs to it if it works, which we pray that it will.

The idea of the administration coming forward with much more aid on top of the things we are doing, I believe, is very admirable. And that cannot be guaranteed for any successive Congress. But if this works, if, in fact, a lot of countries do change many of their habits, they become really better places for the people that they serve, that will be remarked upon, particularly if you have a good reporting system and sort of note all these changes.

As Senator Biden was pointing out, we have noted these remarkable changes in some of our new NATO partners—with unresolved issues that went on for decades that were very injurious to people have been resolved because these nations really wanted to be a part of NATO—and were prepared to settle in ways that they would not have—their political systems could not have given the fractionalization of coalitions and what have you. Suddenly they came together. And that might occur in a big way here.

That is the dramatic aspect of the criteria, of taking them seriously, of having them transparent, of broadcasting who does what, that more children are getting an education, and more women are participating, that disease levels are decreasing. These are remarkable things, which could give a lot of impetus to this.

Now, I suppose to the contrary, some nations may say, “There you go again, United States. You are far too meddlesome. You are reaching into our society and we really are—we do not want to play it that way.” But, I think, to the contrary, many countries, as you suggest already, may be consulting back home within the cabinet.

How do we get up to the standard? We can read it on the Web. We sort of see what is being looked at.

These are fairly reasonable standards for freedom-loving people trying to expand that.

Well, I just invite you to continue to work with our committee. We appreciate your testimony today and your forthcoming responses as always. And this is an important issue. All of you have already studied it a lot, which is important for the body politic to know. There are people at work in your organizations that care about this.

We certainly do on this committee. We thank you very much for your participation, and the hearing is adjourned.

[Whereupon, at 12:20 p.m., the committee adjourned, to reconvene subject to the call of the Chair.]

ADDITIONAL STATEMENTS SUBMITTED FOR THE RECORD

SUBMITTED STATEMENT OF AMERICAN FOREIGN SERVICE ASSOCIATION, JOHN K. NALAND, PRESIDENT AND JOSEPH PASTIC, VICE PRESIDENT FOR USAID

Mr. Chairman and Members of the Committee, the American Foreign Service Association (AFSA) and its 23,000 active-duty and retired members of the Foreign Service appreciate the opportunity to share our views on the proposed legislation to create both the Millennium Challenge Account (MCA) and the Millennium Challenge Corporation (MCC). The Association is both the professional organization and the recognized bargaining agent of the Foreign Service. We thus represent over 1,000 Foreign Service Officers who work at United States Agency for International Development (USAID) and who make up one half of the U.S. government corporate memory on international development.

We applaud the innovation and foresight that has sought new ways of helping the poor of the world through different approaches to delivering U.S. foreign assistance in these changing times. USAID and its employees have proven themselves expert at conforming a world-wide set of unique country development strategies with a broad array of administration and legislative priorities and mandates. It is with this 40 years of development experience and expertise developed "on the ground" that we view the proposed legislation and wish to share our concerns with you.

THE ADMINISTRATOR OF USAID SHOULD BE ADDED TO THE BOARD OF DIRECTORS OF THE MILLENNIUM CHALLENGE CORPORATION

While the Board of Directors of the Millennium Challenge Corporation, the administering body of the MCA, is designed to have cabinet level Directors, AFSA believes that this proposal is sorely deficient and that the Administrator of the United States Agency for International Development should also be a member of the Board because of the specialized expertise and perspective that he can provide during important deliberations on general policy, directions, and programs.

The assistance provided through the MCA is to be additional to existing assistance activities, and regular U.S. programs will continue even in MCA-participating countries. Certainly as both programs exist in a country, a commonality of goals, strategy and policy coherence and coordination between both the MCA and the regular assistance programs will be required. The Administrator of USAID provides a unique nexus for the MCC board in that the Administrator will be able to inform the Board of current programs in a country and particular problems that may be encountered, help to assure the complimentary nature of both MCA and regular programs in a particular target country, and issue policy guidance to USAID.

AFSA believes a sound relationship between the MCA and USAID is essential to the success of both programs and to this Nation's overall foreign assistance effort, and we urge the Committee to include the Administrator of the United States Agency for International Development on the Board of the Millennium Challenge Corporation. The Board should not be limited to a certain level of rank, but rather should be determined by what each of the Directors can add to the success of the effort.

STAFFING ISSUES

With a central mandate of the MCA requiring performance, results and accountability, a key requirement of the Millennium Challenge Corporation will be the ability to effectively monitor the programs in the target countries. The Corporation is to have a staff of 100 people, largely detailed from other agencies, to maintain this oversight and accountability standards over a \$3 billion program in Fiscal Year 2004, and what will eventually become a \$5 billion program.

AFSA firmly believes the Foreign Service of USAID is uniquely skilled, experienced, and positioned to do this work, and should be an integral part of the Washington staff and the effort around the world.

USAID Foreign Service has developed the expertise in formulating coordinated country strategies and implementation of programs. They are skilled in performance management and host-country fiscal responsibility that meet the most rigorous standards. In those few instances when the safeguards failed, it was USAID that "sounded the alarm" and sought the help of investigators. Today, much of the work of USAID is that of a contracting agency that works through a vast network of educational and other non-government grantees and private contractors both large and small. These are the skills needed by the staff of the Corporation, and these are the skills that USAID's Foreign Service has developed over years of "doing the work" of international development.

Further, while USAID will not be managed by the MCA, it is likely that its staff, especially those located in MCA participant countries, will play a strong supporting role. They will be in place in these countries, and they will have the developed skills and experience to provide a constant presence and perspective that a "fly-in, fly-out" staff person from the MCC's Washington headquarters will not have. However, this will present another challenge to the in-country USAID Foreign Service Officer. Because these countries will have both MCC programs and regular, on-going USAID development programs, AFSA is concerned that the support required by the MCA, both programmatic and administrative, will diminish the ability of an already "thinly stretched" staff to continue managing regular assistance programs that they are also responsible for. Certainly the Foreign Service has worked under such conditions before and they have thrived from challenges, but such conditions also take their toll in burn-out and morale, and the Committee should be aware of this. After years of such working situations in the Department of State, and after several serious warnings in a number of important studies, the State Department, under the leadership of Secretary of State Powell, developed the Diplomatic Readiness Initiative to meet a serious personnel shortfall in the State Department.

THE NEED FOR WORKFORCE PLANNING AT USAID

While it is certainly not the responsibility of legislation creating the MCA and the MCC, personnel issues at USAID will influence the success of the MCA.

For USAID to handle its present duties, as well as potential emerging tasks with the MCA, the rebuilding of Iraq and the enhanced Global Health Initiative, it is essential that USAID have the staffing and operating budget needed to do its job. USAID is struggling to recruit Foreign Services Officers at the rate of attrition. However, it is still falling short and not even meeting attrition. AFSA believes the personnel budget and staffing levels provided fall far short of real requirements and that the same workforce planning review that gave rise to the State Department's seminal Diplomatic Readiness Initiative is required at USAID. USAID suffers staffing gaps, lacks a training float, and has too many categories of non-direct hire employees that seriously impacts the work of the Foreign Service at USAID.

Mr. Chairman, as the Committee considers the important skills, talents, experience, and perspective that the Foreign Service can provide to the success of this important MCA initiative, AFSA urges that in later legislation, the Committee also consider the personnel needs of the Foreign Service at USAID.

CONCLUSION

Mr. Chairman and Members of the Committee, the MCA initiative brings needed additional resources and a different, and important approach to the United States' international development efforts. However for this program to fully succeed, the American Foreign Service Association believes and strongly urges the Congress to include the Administrator of the United States Agency for International Development as a member of the Board of Directors of the Millennium Challenge Corporation as it develops the implementing legislation. Further, AFSA believes that the Foreign Service of USAID is experienced, expert, certainly talented and well positioned in this area to play an important role, both in Washington and abroad, in per-

forming the necessary work to meet the objectives of the MCA. AFSA encourages the Administration and the Congress to fully utilize this cadre of dedicated men and women to bring the goals of the MCA to fruition.

The Foreign Services welcome the challenges and opportunities before us as the MCA moves from a concept announced by the President at the Inter-American Development Bank last March to reality, and we thank again the Committee for this opportunity to share our views and concerns with you.

SUBMITTED STATEMENT OF BOB PERCIASEPE, SENIOR VICE PRESIDENT, NATIONAL AUDUBON SOCIETY

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify about the new Millennium Challenge Account initiative proposed by President Bush.

For more than 25 years Audubon has spoken out in support of increased support for international development funding. The reason for this is simple: we believe that stronger economies in the developing world are critical to the long-term survival of birds, wildlife and the habitat they need for survival.

When people are prospering, they think long-term and make investments in environmental protection that range from sustainable agriculture and forestry to sewage treatment plants, clean air and national parks.

When mortality is high, and economies are struggling, people cannot think beyond tomorrow and forests, rivers, wetlands and birds and wildlife inevitably suffer as a consequence.

As one of the oldest and largest environmental organizations in the world, we know the world's interconnectedness predates international banking and the Internet by many millennia. Here in the U.S., "our" songbirds travel the world, from Mexico to Argentina, and from Korea to Tanzania. "Our" fisheries depend on biological food and migration chains that stretch across the globe, and "our" sea turtles may have been hatched on the shores of Costa Rica or Indonesia. The butterflies and dragonflies soon to be arriving back in our gardens are returning to the U.S. after a many-thousand mile migration beyond our borders.

Because we are aware of the interconnectedness of the natural world, we are pleased that the Bush Administration has proposed a significant increase in foreign aid, and are particularly pleased that it focuses on poor nations at the bottom of the global economic ladder.

In addition, we commend the Bush Administration for trying to choose carefully, invest wisely and encourage political and economic development in those countries that are ready for change. What one does with foreign aid—where it goes and how it is used—are extremely important issues. If you believe that development aid can make a world of difference—and we certainly do—then performance measures able to track our success and progress can certainly help make that case if they are meaningful and if the programs are given time to succeed.

As President Bush has noted, economic development in much of the less developed world is tied to political and economic change. Audubon believes, however, that economic development is also tied to demographic change.

The fundamental development challenge ahead is how to cope with the addition of 1.5 billion people over the course of the next 25 years and the addition of 2.8 billion people over the course of the next 50 years. To put these numbers in perspective, we will add more people to the world in the next 25 years as existed in 1925, and add more people to the world in the next 50 years as existed across the globe at the close of World War II.

Nearly one hundred percent of world population growth is now occurring in the developing world. In fact, it is not too much to say that rapid population growth is one of the defining characteristics of underdevelopment, and a core reason for political instability and economic lethargy in many regions of the world.

The relationship between population growth and economic growth is a chicken-and-egg question that has fostered a great deal of nonproductive debate over the years. There are those that say birth rates will naturally decline if democracy and capitalism are embraced, if free markets are allowed to work unfettered, if the status of women is improved, and if gross domestic investments in education are dramatically increased.

No doubt this is true.

That said, in the arena of family planning the most obvious solutions have worked well for a very long time. If we have learned anything over the course of the last 30 years, it is that massive social, political, and economic changes are not necessary

to slow the rate of human population growth. In most cases, simply improving access to the full array of modern contraceptive methods at the level of city, village, and hamlet is often enough to dramatically slow population growth, reduce infant mortality, and strengthen economies at both the village and national level.

- *Consider Iran*—a fundamentalist Muslim country where the status of women is not notably high by western standards. Despite this reality, however, Iran has seen its birth rates plummet due to the government's desire to slow population growth rates in order to strengthen economic development. Iran's state-sponsored condom factory is the largest in the Middle East, and both men and women must take a class on modern contraception before receiving a marriage license. As a result Iran now has a fertility rate that is lower than that of the U.S. As population growth rates in Iran have slowed, political stability and economic growth have gained traction and environmental protection is now on the national agenda. It's immediate neighbors—Afghanistan, Pakistan, and Iraq, where birth rates hover well over 5 children per woman—have had dramatically different economic, political, and environment outcomes over the last decade in part due to the political and economic instability inherent to countries with very rapid rates of human population growth.
- *Consider Sri Lanka*—a county of many faiths and nationalities, which has also made access to a full range of modern contraceptives a national development goal. Today Sri Lanka has a fertility rate that is 50% lower than that of India, its neighbor to the north. As a direct consequence of falling fertility, life expectancy at birth in Sri Lanka is 11 years longer than that of India, and per capita income is 35% higher.
- *Consider Costa Rica*—a predominantly Catholic country whose birth rate is a full 80% lower than that of Guatemala. Not only does the population of Costa Rica enjoy a life expectancy rate 11 years longer than that of Guatemala, it also has twice the per capita income and a thriving ecotourism industry based on the protection and management of its vibrant natural resource base.

The examples above do not stand in isolation. Mexico, Korea, Thailand, and Turkey have all seen dramatic declines in fertility. With those declines has come increased hope for economic development and political change and a growing middle class that counts environmental protection among its concerns.

As seen in the examples above, modern contraceptive methods have been embraced by people of every faith, of every culture, and on every continent. Italy and many other predominantly Catholic countries have the lowest fertility rates in the world. Clearly, in the real world religion is not an obstacle to family planning and contraception is not a controversial issue and need not be treated as such by this Congress or this Administration.

ONE RECOMMENDATION

Audubon believes that the Millennium Challenge Account initiative should include performance measures that track access to modern contraceptive methods in developing countries.

You will note that these recommended performance measures do not track falling birth rates and do not track contraceptive use.

This is intentional.

Audubon believes that in the arena of family planning we should be striving to simply give people what they want. We believe that if people are given all the information, and access to all the modern methods of contraception, then individuals will make the right choices for themselves, for their families, for their communities, for their country and ultimately for the environment.

Just as we believe people will chose democracy if given a political choice, and capitalism if given an economic choice, we believe people in the developing world will also chose a modern contraceptive method if they are made widely available at prices even the indigent can afford.

TWO CAUTIONS

Along with this public policy recommendation, Audubon offers two cautions that fall under the header, "first do no harm."

Our first caution is to make sure that existing development programs, agencies and personnel are strengthened by the MCA initiative. Though we understand that the Millennium Challenge Account initiative is not designed to supplant the U.S. Agency for International Development, it could easily weaken that agency by drawing critical personnel away from core management functions.

It is not entirely clear to us why a new federal bureaucracy is needed to administer grants made under the Millennium Challenge Account initiative. The U.S. Agency for International Development is not broken—it is simply an agency that needs a little more gas (money) and perhaps a new sparkplug or two (good managers empowered by Congress and the President). If key personnel are removed from the U.S. Agency for International Development to manage the Millennium Challenge Account initiative, we may find that we have harmed a vital and working federal agency that has demonstrated real development success over the years. On the other hand, if experienced personnel in the field of international development are not hired to manage the Millennium Challenge Account initiative, we may see waste, inefficiency, and unnecessary redundancy as this new bureaucracy “recreates the wheel”. Both outcomes should be avoided.

Our second caution is that in gauging the success of the Millennium Challenge Account initiative that “sustainable development” be defined broadly and not solely in economic terms. An industry can be profitable with very little of the money staying in the country and while a great deal of environmental damage is occurring. One need only look at logging in Indonesia or coal mining in Kentucky to see examples of economically profitable enterprises that left the people and the environment shattered. This is an outcome that should be avoided, and we recommend that language addressing environmental protection and capital retention within the grantee countries be inserted into any legislation being considered.

We thank you and the members of this Committee for giving Audubon the opportunity to testify today, and we look forward to working closely with you in the future.

ADDITIONAL QUESTIONS SUBMITTED FOR THE RECORD

RESPONSES OF HON. ALAN LARSON, UNDER SECRETARY OF STATE FOR ECONOMIC, BUSINESS AND AGRICULTURAL AFFAIRS, TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR JOSEPH R. BIDEN, JR.

Question 1(a). Five years ago, Congress (led by this committee), carried out an extensive restructuring of the foreign affairs agencies in the Foreign Affairs Agencies Consolidation Act of 1998 (Subdivision A of Division G of P.L. 105–277). As part of that reorganization, the Agency for International Development was brought under the “direct authority” of the Secretary of State, and the Secretary gained the statutory authority to supervise foreign assistance budgets and strategies. One of the purposes of the Act was to strengthen the coordination of U.S. foreign policy and the leading role of the Secretary of State in the formulation and articulation of that policy.

Doesn’t the creation of a new aid organization contradict the objectives of coordination and of giving the Secretary a leading role in policy formulation as set forth by Congress in the 1998 act?

Answer. As Chairman of the Board of the Millennium Challenge Corporation (ICC), the Secretary of State would exercise his responsibility under the Foreign Assistance Act of 1961¹ to supervise and coordinate U.S. economic assistance. The Secretary takes this responsibility seriously and will ensure that the programs and policies of the MCA promote the foreign policy interests of the United States and are well coordinated, both in Washington and the field, with other assistance programs. Secretary Powell also sees his role as Chairman of a cabinet-level MCA Board as essential to ensuring there is strong Cabinet-level accountability for the MCA.

The MCA’s targeted mission reaffirms our development objectives and contributes to an integrated strategy for achieving them. The MCC will focus on spurring growth in the subset of developing countries that have policies in place to use such assistance most effectively to achieve lasting results. USAID, State, and other agencies will continue to deliver humanitarian and regional assistance, to address complex emergencies, and to work with failed and failing States, all issues critical to U.S. national interests. USAID will also work with countries that are MCA “near misses” to encourage them to achieve the development-readiness essential for the MCA.

¹Section 622(c) of the Foreign Assistance Act of 1961 (as amended) provides that “. . . the Secretary of State shall be responsible for the continuous supervision and general direction of economic assistance to the end that such programs are effectively integrated both at home and abroad and the foreign policy of the United States is best served thereby.”)

Question 1(b). Why should Congress not integrate the MCA into the existing structure legislated in 1998—that is, by giving the Secretary of State supervisory authority over the program, but leave it to AID to implement it?

Answer. The MCA represents the President’s vision for redefining and revitalizing development assistance. It is a performance-based initiative that rewards country responsibility. Too few countries are achieving sustained economic growth, which is a prerequisite for reducing poverty. By focusing on those under-developed countries demonstrating the strongest commitment to good governance and sound policies, the MCA will put into practice the main lesson we have learned about development over the past half century. It will do so by challenging countries to create the open and accountable policy environment that our experience shows will lead to economic growth.

A new institution is the best hope to bring about this sea change in our current approach. The existing agencies that might administer the MCA—State and USAID—both have many other bureaucratic mandates and priorities. The MCA needs flexibility to carry out its innovative mandate and should start with a clean slate to give it the best chance to succeed and show that this approach works.

If it is to respond to developing country priorities, the MCA should not be constrained or directed to specific areas of funding. If it is to operate with a lean staff and draw from the best and brightest in the public, private and non-profit sectors, the MCA must have special personnel authority. If it is to be effective, it will need the ability to contract and procure broadly. If it is to succeed in its mission, the MCA must be open to a new way of operating.

All this can best be achieved through an innovative, flexible, narrowly targeted, and highly visible separate organization that complements other assistance. That is why the Administration has proposed the establishment of a Millennium Challenge Corporation (MCC).

Question 2. How does the draft Administration bill affect, if at all, the powers of the Secretary of State as set forth in the provisions of section 1523 of the Foreign Affairs Agencies Consolidation Act of 1998 (Subdivision A of Division G of P.L. 105–277) and section 622(c) of the Foreign Assistance Act of 1961?

Answer. The bill authorizes appropriations for use as foreign assistance outside the authorities of the FAA.

The bill has no impact on assistance provided under Sec. 622 of the FAA., and the Secretary’s broad responsibility for the “continuous supervision and general direction of economic assistance, military assistance and military education and training programs . . .” As the legally established Chair of the cabinet-level MCA Board, the Secretary will be in a position to shape the overall policy direction of the MCA in a manner consistent with broad U.S. assistance objectives.

Question 3. How will 100 people be able to administer \$5 billion worth of assistance?

Answer. Since only a limited number of countries will qualify for the MCA in each year, the MCC requires a smaller staff than would be the case if the MCA had a presence in most poor countries.

The MCA is also designed to be demand-driven and country-owned. We expect each recipient country to take the lead in program design and implementation, eliminating the need for top-down program development by MCC staff.

The MCC will be assisted by existing USG staff in the field. The MCC will also draw upon outside expertise, including for monitoring of MCA activities, where appropriate and effective. It is also envisioned that the MCC will rely on contracts with other agencies or independent contractors for most administrative functions.

The number of permanent employees is not set in stone. Nevertheless, the effort will be to develop a lean and flexible organization that aims for maximum efficiency, with a focused professional core staff.

Question 4. What will be the interaction between the MCA and AID? If, as was suggested at the hearing, the MCA will rely on AID to help administer the money, why create a new government organization with which AID is not directly affiliated?

Answer. MCC and USAID activities will complement each other. The MCC will operate in fewer countries, in a different manner than AID and with a far more focused development mandate.

When both organizations are in the same country, AID will conduct a review of its programs and determine which should continue and which will phase out or become a part of the MCA program. USAID will also target countries that barely miss MCA qualification for assistance to help improve their performance in areas in which they fall short.

By law, USAID reports to the Secretary of State, who is also designated by the Administration to be Chairman of the MCC Board of Directors. This supervision will help ensure that the MCC and USAID work in close cooperation and coordination both in Washington and in the field.

MCC staff in the field will depend upon support from other elements of the U.S. presence, which includes the State Department and USAID, for information, expertise, and representation. As far as specific services, the MCC might contract with USAID or other organizations to provide technical assistance, implement programs, monitor and evaluate programs or disburse funds. The MCC will require flexibility to operate in the most effective manner to achieve its objectives in each country.

Question 5. Mozambique, a country which is expected to be eligible for MCA funding, has an extensive aid program. The fiscal year 2003 request was \$62 million—an increase of \$14 million over the 2002 request. Funding was specifically requested to foster economic growth, democratic governance, maternal and child health, and private sector development. Likewise, the administration requested over \$50 million for development programs in Ghana this year.

Will the aid programs that we have in place in qualifying countries be terminated once they are granted MCA funds? What will happen with the AID programs in Ghana and Mozambique if they receive MCA funds? Will the programs AID is currently engaged in be terminated? How will the MCA and our regular development programs work together?

Answer. It is not yet clear which countries will qualify for the MCA.

Because MCA funds would represent a major increase in a country's development assistance, USAID would likely undertake a strategic review of its programs in MCA qualifying countries. As mentioned in the response to question 4, some USAID programs may well be continued, such as regional programs or those fighting HIV/AIDs or trafficking in persons, while others logically would be phased out or incorporated into MCA program. Some USAID assistance might also be redirected from new MCA countries to countries that just miss the list of better performers to improve their chances of becoming an MCA partner with the United States.

In any case, we intend to coordinate MCC and USAID efforts so that the most successful and important development efforts would continue.

Question 6. Please provide, as requested, a copy of the results of any "test runs" you have undertaken prior to the date of the hearing of the indicators against countries that are IDA-eligible.

Answer. Various runs with different income groupings and shifting data sets could badly mislead as to likely ultimate outcomes. Rather, the Administration stands ready to provide a detailed briefing to interested Committee members and staff on how all phases of the proposed selection system would actually operate.

Question 7. How often does the Administration intend to revise the criteria used to determine MCA eligibility?

Answer. The 16 indicators chosen to help select qualifying countries will continue to be reviewed throughout the next few months and during the life of the MCA. Certain indicators may be dropped in favor of better data, or other indicators may be added if it is determined doing so will help the Board of the MCC choose the most qualified countries based on the criteria of "governing justly, investing in people, and encouraging economic freedom." Any changes will be done in a way to balance the need for flexibility with the need for predictability, so that countries know well in advance by what standards they will be judged. The process will continue to be dynamic, rigorous, transparent, and based on performance.

Question 8. Will there be an Inspector General (IG) for the Millennium Challenge Corporation?

Answer. The MCC will be audited in conformity with the provisions of 31 U.S.C. §9105, in accordance with the requirements for a government corporation. It is not envisioned that the MCC will have its own independent Inspector General.

Question 9. If the answer to the previous question is "No," will any current IG in the government perform IG functions? If not, why not?

Answer. In accordance with 31 U.S.C. §9105, the MCC will either contract to be audited by an Inspector General from an existing agency or by an independent external auditor, as determined by the CEO of the MCC with the approval of the MCC Board of Directors.

Question 10. What is the purpose of section 105(c) of the draft Administration bill?

Answer. In the case of assistance provided under another authority, (e.g. under the authority of the Foreign Assistance Act) and used in conjunction with MCA assistance, section 105(c) would allow such assistance to be used in accordance with MCA authorities. This would simply allow for instances where other U.S. assistance resources can be used in conjunction with MCA's business-like partnership in an effective manner that serves U.S. policy goals and MCA development priorities.

Question 11. Would section 105(c) of the draft Administration bill permit a transfer from any other appropriation account, whether from accounts under the Foreign Operations Act or any other Act? Would funds transferred be subject to any restrictions contained in the Act from which the funds were transferred?

Answer. Section 105(c) is not a transfer authority. The account being used would need to be authorized to be available to provide foreign economic assistance. Such funds, if used in conjunction with MCA assistance would, under section 105(c), get the benefit of the authorities applicable to MCA assistance.

Question 12. Under the draft Administration bill, is the Corporation a government corporation as that term is defined in 5 U.S.C. § 103?

Answer. Yes; it is the same as that defined in 5 U.S.C. § 103(1).

Question 13. If Congress were not to waive nearly all laws, as is contemplated by section 105(b)(1) of the draft Administration bill, what major laws, specifically, should be waived to provide the necessary flexibility for this program?

Answer. We are hopeful that Congress will accept the language proposed in section 105(b)(1). It is for that reason we have made a country's eligibility for MCA assistance subject to its eligibility to receive other economic assistance under the Foreign Assistance Act.

Question 14. What is the legal effect of, section 107 of the draft Administration bill?

Answer. Section 107 requires that each Millennium Challenge Contract describe the purposes of MCA assistance, the activities that will be funded to achieve these purposes, and the period of time over which MCA assistance will be provided for these activities and purposes. In essence, it holds the MCC and MCA partner countries accountable for a shared business plan.

Question 15. Why is section 204(e) of the draft Administration bill necessary?

Answer. Section 204(e) provides the MCC with authority to expedite the procurement process in the event that the Board or the CEO believes this to be necessary to effectively manage the program.

Question 16. Does any other foreign affairs agency have the authority contemplated by section 204(e) of the draft Administration bill? If so, which agency or agencies?

Answer. Section 204(e) is a narrower version of section 633(a) of the Foreign Assistance Act.

Question 17. Section 205(a)(7) of the draft Administration bill purports to grant certain privileges and immunities to individuals employed by the Corporation. Please explain how legislation can grant such immunities.

Answer. Only the host country can grant privileges and immunities. Section 205(a)(7) should state:

The CEO should seek, through the U.S. Department of State, to obtain privileges and immunities at least equivalent to those of the technical and administrative staff of the Mission of the United States to such country for individuals employed by the Corporation and, as appropriate, individuals detailed to or contracted by the Corporation. Such individuals shall be subject to 22 U.S.C. 3927 in the same manner as United States Government employees.

Question 18. What precedents are there for the following provisions of the draft Administration bill—

- a. Section 205(a)(2).
- b. Section 205(a)(3)

Answer. Given the relatively small size of the MCC, the MCC will require broad discretion to employ individuals without regard to civil or foreign service limitations. It is anticipated that in order to sustain a fresh and innovative approach staff would not serve more than 5 years and therefore a more flexible model than the Civil and Foreign Service systems would be appropriate. Sections 205(a)(2) and 205(a)(3) were based on, and expanded upon, authorities provided to the Overseas

Private Investment Corporation (section 233(d) of the Foreign Assistance Act of 1961), the Enter-American Foundation (section 401(e)(3) of the Foreign Assistance Act of 1969), the African Development Foundation (sections 506(a)(5) and 506(a)(7) of the International Security and Development Cooperation Act of 1980) and to agencies administering foreign assistance programs (section 625(b) of the Foreign Assistance Act of 1961). Although not used as a model, the Tennessee Valley Authority is also provided broad authority to appoint and compensate employees without regard to the Civil Service laws applicable to officers and employees of the government (16 U.S.C. section 831b)

Question 18. What precedents are there for the following provisions of the draft Administration bill—

c. Section 205(b)(3).

Answer. Section 205(b)(3) was based on language in the E-Government Act of 2002, section 209(c), that provides for the assignment of employees from private sector organizations. This authority allows for additional flexibility in bringing under one roof the best and brightest detailees from federal agencies, the NGO/PVO community, and the private sector.

Question 19. Why is section 205(a)(1)(D) of the draft Administration bill necessary, given that the “notwithstanding” language in section 205(a) does not purport to waive any provisions of Title 18, United States Code.

Answer. It was included only to indicate that those provisions would not be waived, but it is technically unnecessary.

Question 20. Would all employees of the Corporation be expected to have security clearances?

Answer. Employees would be expected to have security clearances if their jobs required access to classified materials, e.g., reporting on developments in foreign governments. Such reporting, for example, could be especially important regarding trends and developments related to issues such as national leadership, governance, and corruption.

RESPONSES OF HON. ANDREW S. NATSIOS, ADMINISTRATOR, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR JOSEPH R. BIDEN, JR.

Question. What is the average size of the assistance or grants portfolio for which USAID officers are responsible?

Answer. Generally speaking, no single USAID officer is responsible for managing a grants portfolio. Our portfolios are managed by teams of officers working together from our technical, program procurement and financial offices. On a per capita basis, USAID direct hire officers serving overseas manage roughly \$7.5 million.

Question. Please describe how the Executive Branch currently implements Section 102(b)(1) of the Foreign Assistance Act of 1961, which requires that development assistance from the United States “shall be used in support of, rather than substitution for, the self-help efforts that are essential to successful development programs and shall be concentrated in those countries that take positive steps to help themselves.” Please describe how the provisions of the Millennium Challenge Account will operate differently from this principle.

Answer. The principle of self-help has been central to USAID’s development assistance programming and attempts to achieve sustainable development for years. What we have learned over the decades is that the likelihood of achieving development and related foreign policy results is greatly enhanced if countries take ownership for the development process. Governments must be committed and willing to put in place the necessary enabling environment economic, social and political. But it is also important for the private sector, nongovernmental and local governments to participate. This principle is embodied in our strategic planning, resource allocation, and performance monitoring and evaluation systems. It is primarily implemented through our overseas field offices which are held accountable for intended results. Where needed, programs incorporate assistance to encourage democratic participation and to strengthen institutions. Further, the principle of self-help is reflected in our requirements for host country contributions and cost-sharing for NGO grantees.

Given this history and the importance we place on participation, commitment and self-help, we are taking several steps to more broadly and more aggressively apply the principle and better link performance to foreign aid programming and budg-

eting. A prime example is the new “strategic budgeting” model we are developing. When operational, we will be able to more objectively relate country allocations to a combination of need, commitment, program performance and foreign policy priorities.

I should note that the importance of self-help and ownership by the recipient country is shared by the donor community. Ways of better achieving this ownership are the subject of active discussion by the OECD Development Assistance Committee, and concrete recommendations are being developed. We are actively engaged in this dialogue.

The concept of the MCA is indeed very similar to that of Section 102(b)(1) requiring that U.S. development assistance support, rather than substitute for self-help efforts, and that it be targeted at countries taking positive steps to help themselves. However, the MCA goes a step further in targeting large amounts of assistance on the poorest countries that have demonstrated a commitment to governing justly, investing in their people, and promoting economic freedom, as measured by a set of concrete and objective criteria. Because the MCA will be working with the best performing countries, it will be founded on a genuine partnership between the U.S. and the recipient country, and will strive to achieve a broad coalition around development investment within a country. A country’s MCA program should reflect an open consultative process, integrating a broad range of interests, and should bring an inclusive perspective to discussions between the country and the MCA.

Question. Please describe how the Executive Branch currently implements Section 102(b)(4) of the Foreign Assistance Act of 1961, which requires the President to “assess the commitment and progress of countries in moving toward the objectives and purpose of [chapter 1 of the Act] by utilizing criteria.” a non-exclusive list of which follows.

- a. How is such assessment conducted? Who conducts the assessment?
- b. Is the assessment conducted annually? If not, how frequently is it conducted?

Answer. USAID assesses such information on every country annually by reviewing available statistics. The assessment is done in the Bureau for Policy and Program Development, and is reported within the Agency, to Congress and to the American people in the Agency’s Annual Performance Report. Some of the data is generated within the U.S. Government, including work done by USAID, the Census Bureau, the Commerce Department and the State Department, and some of it is dependent on work done by other organizations such as the World Bank, Freedom House, and Transparency International.

These assessments are done annually. In some cases, annual estimates are made by extrapolating from data that are not collected frequently. These are done by such agencies as the Census Bureau and the World Bank with well known and published methodology.

USAID is committed to using data to assess the commitment and progress of countries in moving toward the objectives and purposes of the FAA of 1961, the New Directions Act of 1972, and many additional concerns raised in subsequent Foreign Operations Appropriations Acts. Obviously, the indicators have changed since 1961 as we have learned more about tracking country progress and the most effective and efficient indicators. At the outset, it should be stated that USAID does not attempt to duplicate the extensive research and statistical analysis that other organizations such as the World Bank and the United Nations do. Such a duplication of effort would not be a wise use of our resources.

Factors referenced in the FAA:

- (A) Increase in agricultural productive per unit of land through small-farm, labor-intensive agriculture;
- (B) Reduction of infant mortality;
- (C) Control of population growth;
- (D) Promotion of greater equality of income distribution, including measures such as more progressive taxation and more equitable returns to small farmers;
- (E) Reduction of rates of unemployment and underemployment;
- (F) Increase in literacy;
- (G) Progress in combating corruption and improving transparency and accountability in the public and private sector.

The major place that these figures are analyzed and reported is in the annual Agency Performance and Accountability Report, which was submitted to Congress this year on January 31, 2003. Trends are analyzed and reported, and made available to Congress and the American public. However, the Agency is consistently using such measures at both the country and Washington levels to ensure that the

country situation is understood and trends monitored and programs adjusted to best meet these needs.

Performance and Accountability Report country level indicators:

1. Average Annual Gross Domestic Product Growth Rate per Capita;
2. Index of Economic Freedom Scores (trade policy; fiscal burden of government, including tax policies; government intervention in the economy; monetary policy; capital flows and foreign investment; banking and finance policy; wages and price controls and subsidies; property rights; regulation and black market);
3. Trends in Net per Capita Agricultural Production;
4. Per Capita Net Food Production Index;
5. Annual Micro-enterprise Lending: a) total funding, b) active number of loans, c) percentage of loans made to women;
6. Children enrolled in primary schools;
7. Hectares under improved environmental management;
8. Total Fertility Rate;
9. Contraceptive Prevalence Rate;
10. Under-five child mortality rates;
11. Adult HIV prevalence rates;
12. Freedom House Index scores (political rights and civil liberties).

In addition, USAID provides several additional reports to Congress that address some of the other original questions in the FAA. These include:

1. The Progress in Education annual report, which includes, among many other things, reports on progress in literacy.
2. The report to Congress pursuant to the International Anti-corruption and Good Governance Act (P.L. 106-309) annual report. While this report is only two years old, the Agency has been tracking corruption for many years through a variety of surveys and indices, including the Transparency International index.

For those issues raised in the original legislation that are not directly tracked, USAID has developed more appropriate approaches:

1. It is unclear that "increase in agricultural productive per unit of land through small-farm, labor-intensive agriculture" is the appropriate mechanism to improve food available and the economic situation of small farmers in the current world. However, USAID does do substantial micro-lending to farmers and other small-holders, that is tracked in the micro-enterprise lending indicator listed above. As noted above, we do track overall agricultural productivity and, where it is appropriate, track specific factors such as "non-traditional" exports, which are likely to be produced by small agriculturalists.

2. Traditional measures of income inequality and of un- and under-employment are almost useless in tracking income and employment trends. This is even a difficulty in the United States, where traditional unemployment figures do not include those who have ceased looking for work, and many who are employed in non-traditional jobs. Instead, we feel that elements of the economic freedom scores, cited above, track government commitment to improving the business climate for creating employment in the private sector, particularly among small and medium-sized businesses which are the main engines of job growth.

In addition to these sources, USAID maintains the Economic and Social Database which gathers a wide variety of data from around the world. This is immediately available to Agency managers and policy-makers online, and is widely used both to access existing data sources, and to research new questions as they arise.

RESPONSES OF HON. ALAN LARSON, UNDER SECRETARY OF STATE FOR ECONOMIC, BUSINESS AND AGRICULTURAL AFFAIRS, TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR JAMES M. JEFFORDS

Question. During the hearing Senator Lamar Alexander posed a question to Al Larson. Senator Alexander encouraged the board to be as flexible as possible in considering the sectors it will fund. He noted that Gabon has set aside 12 percent of its land for national parks. He asked whether conservation would be a criteria that would be considered in qualifying for MCA funding. In responding, Mr. Larson rephrased Senator Alexander's conservation example in terms of achieving ecotourism. However, Mr. Larson did not fully answer the question: would conservation be considered as a criteria, perhaps under the "investing in people" category, and would it be a sector for MCA funding?

Answer. The goal of the MCA is to achieve poverty reduction through economic growth. MCA criteria for selection measure how well a country is performing in "ruling justly, investing in people and encouraging economic freedom." These criteria

were chosen because they correlate to economic development. Conservation, per se, is not a criterion for selection. However, the indicators do measure a number of the conditions necessary for conservation of natural resources: effective participation in governance by civil society, effectiveness of regulations, and protection of private property to name a few.

The legislation identifies six examples of areas for MCA funding that are directly tied to a country's productivity and economic growth, namely agriculture, education, private sector, governance, health, and trade. These areas are meant to be illustrative, not exclusive. Because flexibility and country ownership are key concepts of the MCA, decisions on specific MCA investments will be made on a country-by-country basis. MCA countries will identify investments that fit within each country's overall growth strategy. While eco-tourism, environment and water projects were not specifically mentioned as examples, a participating country and the MCC might choose to invest in these areas to support its development and growth strategy.

Question. Last year, at several meetings in the United States and internationally leading up to the World Summit on Sustainable Development, the Administration's MCA was highlighted. For countries that qualify for MCA funding, could MCA funding be used to achieve any of the outcomes or goals from the WSSD? If so, which ones in particular?

Answer. The MCA could help a participating country achieve a number of the outcomes or goals stressed at WSSD. These include improved governance, safe water, clean energy, including rural electrification, mass transportation, health, education, eco-tourism and agricultural development.

As described in the response to the previous question, MCA funding will be country driven. Thus, a country could choose a program in any area that would be critical to achieving its development objectives.

Question. On numerous occasions the Administration has said that the MCA will not be a substitute for current humanitarian assistance. However, humanitarian assistance stays either the same or decreases in various areas of the 2004 budget. Why? Are similar decreases anticipated in the 2005 and 2006 budgets?

Answer. For FY 2004, the Administration has requested a total of \$2.476 billion for humanitarian assistance purposes. This request is an overall increase of \$230 million over the Administration's initial FY 2003 request for comparable humanitarian assistance (although less than the amount now available from the just-enacted Omnibus Appropriations bill). The recently transmitted FY 2003 supplemental request, as you know, seeks additional humanitarian assistance for Iraq.

MCA funding is requested for the purposes of economic development and can not be compared to nor offset humanitarian assistance requirements.

We are not able to estimate the requirements for humanitarian assistance funds in FY 2005 and 2006 at this time.

