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MATCHING CAPITAL AND ACCOUNTABILITY—THE MILLENNIUM CHALLENGE ACCOUNT

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE AND TECHNOLOGY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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MATCHING CAPITAL AND ACCOUNTABILITY—THE MILLENNIUM CHALLENGE ACCOUNT

Wednesday, June 11, 2003

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL,
MONETARY POLICY
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:14 a.m., in Room 2128, Rayburn House Office Building, Hon. Katherine Harris [acting chairwoman of the subcommittee] presiding.

Present: Representatives Ose, Kennedy, Feeney, Hensarling, Barrett, Harris, Maloney, Watt, Waters, Lee, Sherman, Frank (ex officio), Baca, and Crowley.

Ms. HARRIS. [Presiding.] The hearing of the Subcommittee on Domestic and International Monetary Policy, Trade and Technology will come to order.

Without objection, all members' opening statements are made part of the record.

This morning's hearing provides us with an outstanding opportunity to learn about President Bush's historic initiative to comprehensively reform our nation's financial assistance to the developing world.

We are fortunate that several of the Bush Administration's distinguished leaders have joined us to explain how the President's Millennium Challenge Account, the MCA, will achieve this objective.

Treasury Secretary John Snow appeared before the full Financial Services Committee in May to describe the Administration's international economic policies. The MCA played a prominent role in his testimony. I look forward to hearing specific examples that will illustrate the vision he outlined during this morning's testimony.

On behalf of Chairman Oxley, I wish to express our appreciation to the Honorable John Taylor, Under Secretary for International Affairs in the Department of the Treasury; the Honorable Alan Larson, Under Secretary for Economic, Business and Agriculture Affairs at Department of State; and the Honorable Andrew S. Natsios, the Administrator of the Agency for International Development, for their insights.

The Millennium Challenge Account is aptly named. Helping eligible countries help themselves presents them and us with an extraordinary challenge. Eligible nations can prompt the challenge of

improving their governance, investing in their people and promoting economic freedom. We face the challenge of helping them succeed while holding them accountable. We believe that the construction of thriving, prosperous societies is inseparable from good leadership, economies based upon sound market principles and major investments in health and education.

In short, for a country to be successful, its people must be successful. As illustrations of this axiom, Americans can point to our own experience, as well as to the transformations that have occurred in South Korea, Chile and Botswana.

The MCA constitutes a bold initiative that demands responsibility, transparency and accountability. It builds upon, rather than detracting from, our other bilateral and multilateral aid programs. It represents a way forward, not backward. It creates a model of interagency corporation without a bloated new bureaucracy, relying upon the expertise of the Departments of Treasury and State, as well as the Agency for International Development. I understand that the Office of Management and Budget will serve in the corporation as well.

The challenge is not just extended to the applicant countries, but also to our government guiding this process forward. The jurisdiction of the Treasury Department, International Finance and Multilateral Development Banks, I am particularly concerned how coordination is undertaken so that duplication of efforts or overlapping is avoided.

Like any sound investment strategy, the MCA is based upon a long-term outlook. The President takes a positive step forward by proposing $1.3 billion for the MCA in its first year and ramping up to $5 billion by its third.

The Administration and our taxpaying constituents can rest assured that Congress will be very involved in this process. Sixteen performance indicators proposed by the Administration will gauge just how seriously committed countries are to ruling justly, investing in their people and promoting economic freedom.

With indicators from regulatory quality, to political rights, to public expenditures on health and primary education, the range of indicators is expansive and objective. We are talking about routing out corruption, establishing respect for human rights and adhering to the rule of law, as well as investing in better schools and health care.

These are long-term solutions and goals, but with the leadership of an MCA corporation, I am confident that applicant countries, which develop successfully, will provide a strong civil society and a sound, market-driven economy to guide future international development.

Thank you again for your testimony today, and I look forward to your comments.

Are there additional opening statements?

Mrs. MALONEY. I thank the Chairlady for yielding.

And I thank very much our witnesses, Mr. Taylor, Mr. Larson and Natsios, for being here.

And I just want to share with you, I just came from a Joint Economic Committee, where I submitted the Freedom From Debt Act legislation that I will be introducing today to require the United

States to negotiate in the IMF, World Bank and other appropriate multilateral development institutions for the IMF and World Bank to relieve the debt owed by Iraq to these institutions.

And I feel that this is in line, really, with many of the MCA's priorities and challenges, and certainly would benefit the Iraqi people. So I will be forwarding a copy of this legislation to you to see and discuss with the Administration, and I am hopeful that you will be supportive in a bipartisan way.

I very much look forward to your testimony today. And in reviewing the MCA, I think the goals are laudable. It is very important, but basically, I would like to see more of an emphasis or inclusion in it on women, children, families, and, I would say, reproductive health, all of which are very much tied to the stability of countries, the environment and, really, the health and well-being of families. If you have a strong family, you have a strong village. If you have a strong village, you have a strong country.

But I would, in a broader way, just like to thank this Administration for their increasing commitment to increasing foreign aid to the world's poorest nations. This is truly a historic step, and if fully implemented, is one of the largest increases in foreign-aid spending in the past 50 years. Clearly, we need full funding and a full commitment to getting the aid to those countries who need it most.

I look forward to hearing about the concept of the program and the criteria for country eligibility. I agree that it is important to discuss the political and economic development when we discuss indicators for aid recipients. However, I notice one area that is directly related to economic development which is missing from this debate: demographic change.

October 12, 1999, was designated by the United Nations as the day the Earth's population would reach 6 billion. By reaching the global milestone of 6 billion was a testament to the significant progress we have made in improving the quality of life for each of the world's citizens, one-third of the world's people still face a world of poverty, poor health and pollution.

As the third most populated country on Earth, I strongly believe that the United States must affirm its status as a world leader and meet its financial responsibilities. The needs of 6 billion people cannot be met unless the United States fulfills its promise to help provide population and development funding in countries that cannot afford it themselves.

When we address poverty eradication, we must address access to modern contraceptive methods. As Mr. Natsios knows, USAID investments in family planning helps stabilize population growth in strategically important countries and resulted in the creation of strong U.S. trading partners such as Korea, Taiwan and Thailand.

More than 99 percent of population growth is occurring in the developing world, where population pressure is contributing to deforestation, water and food shortages, global warming, wildlife dying and other environmental concerns.

Expanding populations undermine developing-country efforts to provide citizens with adequate health care, food, education and jobs. These conditions slow economic and social development, thereby jeopardizing the potential for these countries to be reliable allies, good trading partners and growing markets for U.S. exports.

Supporting voluntary international family planning programs, universal access to reproductive health care and other services means stable populations, growing economies, improved environmental conditions and a better world for everyone.

We should be considering these issues when we discuss performance measures for eligible countries for the Millennium Challenge funding.

And I want to close just with one brief story. I visited India once, and I was very much taken by the world's largest democracy that had a strong independent court system, a form of democracy, and spoke English and an industrious population.

And I asked the American Ambassador, "What would be most important thing that we could do to help India?" I just loved the country. I thought he would say economic development, I did not know what he would say. I was stunned at his answer—and this is Ambassador Wristen, and he was a professional career ambassador. And his statement was, "family planning." He said that women and men and families gathered in lines at villages, lined up, asking for support and information about family planning.

So I feel that that should be something that I hope that you will consider in the criteria and information that you put forward with the MCA accounts. It is a good first start, but I think this should be included.

Thank you.

Ms. HARRIS. Are there any additional opening statements?

Mr. FRANK. Madam Chair?

Ms. HARRIS. The gentleman from——

Mr. FRANK. Do you have one on the other side?

Ms. HARRIS. I did not see anybody from this side.

The gentleman from Massachusetts is recognized.

Mr. FRANK. Thank you. I appreciate the fact that we are having this hearing, and I am delighted that we have this really impressive panel of high-ranking officials.

I think one of the greatest gaps in our international policy over the years has been the absence of a forceful and sustained economic development strategy. It has been too often subordinated to other political considerations. Those are important, but they ought to be pursued on their own.

And alleviating desperate poverty is, first of all, important for itself; secondly, because it does, if we are successful, create a less unsafe world. I do not think—the direct relationship people try to draw between terrorism and poverty is clearly wrong. Terrorists are not hungry. They are not dealing with poverty. Osama Bin Laden is not a social worker and has, as nearly as I can see, no decent instincts at all.

But what happens when you have this sense of despair and poverty, I think, is that the climate for terrorism increases. That is, more people are supportive, less are willing to join in the effort than would be in their own interest.

So there is a self-interested argument here, but it seems to me, you know, we should not denigrate ourselves. We too often, when we want to do something because it is the right and moral, correct thing to do to alleviate human suffering, we think we have to come up with a more instrumental reason. I think we ought to acknowl-

edge that the richest society in the world's history can spend some fairly small percentage of its wealth trying to alleviate desperate poverty, and we will also benefit from it.

I just have a couple of questions, and I mentioned this to Under Secretary Taylor, and I hope you will be able to address it, and that is: There are criteria, as there should be, but we obviously do not want people bouncing in and out. If people join in—and particularly I am concerned because the criteria, it is a relative thing, you are being graded on a curve here. Technically, if a country does the right thing, it qualifies, it gets into the program, and it continues to do well, but other countries start doing better, its eligibility might be in question. And I think we obviously need to have some guarantees of continuity.

Secondly, I did have a concern because I was glad to see the criteria. Corruption is an absolute. Human rights and freedom is not. And that troubles me some.

There was a period when we were hoping that economic development would, in itself, lead to greater political freedom. Sadly, that does not seem to be empirically carried out. The People's Republic of China seems to be showing that you can progress economically without necessarily progressing in human rights. Others in the Asian area seem to, sort of, show that as well.

So I would hope that the human rights and freedom part would get a kind of equal treatment. And the notion that, technically, theoretically, you could be very bad on those and still qualify is somewhat troubling.

Gentlemen, I welcome the initiative. I look forward to being supportive of it, and I think that it has a great deal of promise.

Thank you, Madam Chair.

Ms. HARRIS. Thank you.

Are there additional opening comments?

The gentleman from California is recognized.

Mr. SHERMAN. Thank you.

I strongly support foreign aid in general and this Millennium process in particular. But it will be difficult to explain to our constituents why one criteria is missing from the proposal, and that is the degree to which the country seeking aid has cooperated with us in the war on terrorism.

Now, there are some countries that, blessedly, are simply irrelevant. There are not any international terrorists there. We have not asked them to do anything.

But in the Committee on International Relations, I will be proposing, and I hope that this subcommittee generally supports, the idea of an amendment to this proposal—and perhaps the panelists could focus on this—that would add as a criteria the degree to which the country, upon request, if it has been requested, has aided the United States in preventing international terrorism and apprehending terrorists.

Otherwise, you may see a circumstance in which a country meets all the qualifications, gets a grant or a loan, and has refused to extradite, refused to cooperate, refused to trade information. And when that happens and that hits the headlines, support for further appropriations will shrivel.

So to think that we can take our desire to help the poorest and divorce it from the expectation of our constituents, that we will do everything possible to protect them from terrorism—even if you do not want those two things married, they will be married. And best we do it at the outset than do it in an unfortunate program development later.

I yield back. Thank you.

Ms. HARRIS. Thank you.

Are there any additional opening statements?

Mr. FEENEY. Madam Chairman?

Ms. HARRIS. Yes, the gentleman from Florida is recognized.

Mr. FEENEY. Thank you, Madam Chairman.

I am very interested in the Millennium Challenge Accounts because of the way it reforms the historic pattern of foreign aid in America. The truth is that foreign aid, in terms of the effect it has had on the companies that we have worked with, historically, in my view, reminds me of Franklin Delano Roosevelt's description of the welfare system. And that is that it tends to become like a narcotic and creates dependency rather than good behavior.

And to the extent foreign aid has done anything for us positively, it has been because of the geopolitical interests that we have and basically buying friends for a temporary period of time. But even that, ultimately, it seems to me that historically the countries we help the most with foreign aid, on the long run, turn around and bite the hand that feeds them the most aggressively.

And so there is this inverse, and directly inverse, relationship between the amount of money we give countries and how bad off they are, in terms of prosperity.

The nice thing about the Millennium Challenge Accounts is that, for the first time, we are going to try to, in a coherent manner, tie future behavior to the amount of foreign aid that we hope to deliver.

And it seems to me, what we have done historically is to carve out a part of the Americans' prosperity and wealth and take money from taxpayers in America and give it to other countries. What we want to do here, I think, is to share the recipe for success and prosperity that has led us to be the shining light.

And one of the things that I am very interested in is the way that we are going to define countries that are moving in that direction, because, by definition, the 74 or 75 countries that we are talking about participating in this have the worst record of creating prosperity.

So it is going to be very interesting how you incentivize people and how you stay on them on a regular basis to do things like create a rule of law that respects property rights, both real property rights and intellectual property rights. How are you going to repeatedly insist on transparency and lack of corruption, low marginal tax rates for both investment and for earner's free trade?

For example, we do not give much directly, in way of foreign trade, to Hong Kong, Taiwan, South Korea or Thailand, but we have given them the recipe for success. They do not need foreign aid because they know what it takes to create prosperity.

And finally, I hope that we will address the issue of democracy. Hong Kong was hardly a democracy for the last 50 years, but they

finish number one routinely on the Heritage Foundation's list of free nations because of their economic approach to prosperity. And they now have a higher per-capita income than even Great Britain, who was the parent of the economic freedom in Hong Kong.

So, I hope you will basically tell us how we are going to change from a system of, in my view, failure in foreign aid to maybe success and ultimately weaning these 75 nations and other nations off of the burden on American taxpayers.

Ms. HARRIS. Excellent.

Are there any further additional opening statements? Very well.

I would like to welcome a couple of new faces who are appearing before this subcommittee and one familiar face. We welcome again Dr. John Taylor, Under Secretary of Treasury for International Affairs, at the Department of Treasury.

Dr. Taylor has a very distinguished academic and professional record. He received his undergraduate degree from Princeton University and his Ph.D. from Stanford University. He has taught economics at Columbia, Yale, Princeton and Stanford Universities.

In addition to these academic positions, Dr. Taylor was a member of the President's Council of Economic Advisors during the Administrations of President George Herbert Walker Bush. Moreover, he has also served in the private sector as an analyst for Alan Greenspan's Wall Street firm, Townsend Greenspan, in the later 1970s and early 1980s, where he studied world commodity markets.

I also welcome Dr. Alan P. Larson, Assistant Secretary of State for Economic and Business Affairs. Dr. Larson was sworn in as Assistant Secretary of State for Economic and Business Affairs in July 1996. Prior to his appointment by President Clinton, Mr. Larson served as Deputy Assistant Secretary for International Finance and Development. He served in that position for more than two years.

From 1990, Mr. Larson served as America's ambassador to the Organization for Economic Cooperation and Development in Paris. Mr. Larson has a B.A., MA and Ph.D. degrees from University of Iowa. He also attended John Hopkins' School of Advanced International Studies.

We are also pleased to welcome the Honorable Andrew S. Natsios, Administrator of the U.S. Agency for International Development. Andrew S. Natsios was sworn in on May 1, 2001.

For more than 40 years, USAID has been the lead U.S. government agency providing economic and humanitarian assistance toward transitioning and developing nations. President Bush has also appointed him special coordinator for international disaster assistance and special humanitarian coordinator for the Sudan.

Mr. Natsios is a graduate of Georgetown University and Harvard University's School of Government, where he received a master's degree in Public Administration. After serving 23 years in the U.S. Army Reserves, Natsios retired in 1995 with the rank of Lieutenant Colonel. He is a veteran of the Gulf War.

Without objection, your written statements will be made part of the record. And you will each be recognized for a five-minute summary of your testimony. We will start with Secretary Taylor, then Secretary Larson and Administrator Natsios.

Thank you.
Welcome.

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

Mr. TAYLOR. Thank you very much, Congresswoman Harris and other members of the committee, for inviting us to testify. My testimony follows that of Secretary Snow, as you indicated in your opening remarks, on May 13th, where he described our overall international economic policy and the Millennium Challenge Account in particular. And we are going to focus on the Millennium Challenge Account today, of course.

I am very pleased to be on this panel with Alan Larson and Andrew Natsios. The three of us, and many others in the Administration, have worked together since the President announced this initiative in March of last year, spent many hours working together. I think it is a good example of interagency cooperation, and I expect that that is going to continue very much as we move into the operational phases of the Millennium Challenge Account.

I want to focus on how the Millennium Challenge Account fits into our overall economic strategies, economic development strategies, in my testimony.

As you know, there are 3 billion people in the world living in what most Americans would call extreme poverty. The United States has worked to combat this problem of poverty in many ways.

This Administration, under President Bush's leadership, has developed a new economic strategy—I would call it a growth agenda—to deal with the poverty around the world, and the Millennium Challenge Account is part of that strategy.

The strategy is to channel more funds, more resources, into countries that are following pro-growth policies, policies that we know are essential for reducing poverty—poverty will not be reduced unless countries grow more rapidly—but also to channel funds in a way that we can measure the results. So it is more funds, focused on pro-growth policies, and measuring the results that are the driving force behind the policy.

We are following this policy with respect to the multilateral development banks, as this committee knows well. For example, we have advocated an incentive contribution scheme to IDA, the arm of the World Bank that deals with the poorest countries.

And I would hasten to add that we appreciate the work of this committee in moving ahead on the very important authorization for IDA, for the Asian Development Fund and the African Development Fund, which still are very important for our Administration's policy. And we will work with the committee as much as it requests in moving ahead with these authorizations.

This pro-growth poverty-reduction agenda is also the driving force behind the Millennium Challenge Account. As I indicated, poverty reduction requires stronger economic growth.

And I would focus on productivity growth. Poverty cannot be reduced unless workers can earn more, be employed. And they earn more by producing more. It is as simple as that. Productivity rises because there is more capital, more tools for people to work with, for workers to work with, and because they have better technology.

More tools, better tools, better ideas, is how workers can produce more and therefore earn more and be removed from poverty.

As you look around the world, there are barriers to both the use of capital, the movement of capital and the transfer of technology. Those barriers have to do with poor governance, a lack of rule of law.

A second barrier has to do with poor education, poor health, lack of investment in people.

And the third barrier to the transfer of technology in growth and capital is restrictions on economic transactions or restrictions on economic freedom.

The Millennium Challenge Account attacks all these barriers. Its strategy is to support countries which do the things that will lead to economic growth.

And as President Bush has said, and as you said in your opening, Congresswoman Harris, that is governing justly, it is investing in people and it is encouraging economic freedom.

So what we have done, the people in front of you today and many others in the Administration, is worked hard to find specific measures of economic performance that fit into these three categories that President Bush highlighted.

What we have looked at, in consultation with many people, inside and outside of government, is we have focused on a total of six indicators that represent governing justly. Two of those indicators come from Freedom House. They measure civil liberties, and they measure political rights.

Four of the indicators, four of those six, come from the World Bank Institute. They are indicators that measure voice and accountability, the effectiveness of government, the rule of law and the control of corruption. Just the things that we need to address—countries need to address if they are going to increase growth and reduce poverty.

There are four indicators that have to do with investment in people. Two of them focus on the inputs to education and to health—that is, the fraction of GDP spent on education and health. Two of the indicators focus on measures of output: What do you get from your investment in education? What do you get? You get completion rates, more kids getting out of elementary school and learning things. What do you get for your health expenditures? Better immunization rates. So those are two of the measures of output that we focused on.

And then with respect to encouraging economic freedom, there is a total of six indicators. Some of them are more macroeconomic; some of them are microeconomic. On the macroeconomic side, having a low inflation rate, a budget that is not in a great deal of deficit. On the microeconomic side, countries that find ways that makes it easier to start a business, countries that are open to foreign trade, countries where regulatory barriers to starting businesses is low.

So focusing on these indicators, we have tried to put in a great degree of objectivity in what the criteria are from policies that raise growth.

What we would like to do is say that countries that are above the median in half of the indicators in each category would qualify for funds under the Millennium Challenge Account.

There will be a board, a committee, to make the decisions ultimately, and that committee will exercise judgment in using these indicators, because no indicator is perfect, no indicator is free from some error. So the idea is the committee will ultimately make the decisions.

Ms. HARRIS. Mr. Secretary, could you——

Mr. TAYLOR. And then, finally——

Ms. HARRIS. Thank you.

Mr. TAYLOR. ——finally, we are going to insist that every single contract, every single form of assistance has strict, measurable results, where we say what should be done and measure what is done in developing the aid.

So I urge you to support this important legislation, and will conclude with that. Thank you.

[The prepared statement of Hon. John Taylor can be found on page 53 in the appendix.]

Ms. HARRIS. Thank you.

Mr. Secretary Larson?

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

Mr. LARSON. Madam Chairperson, Congresswoman Maloney and distinguished members, last March, President Bush caught the attention of the world when he called for a new compact for global development that would link greater contributions from developed countries to greater commitments and responsibility from developing countries.

The Millennium Challenge Account is intended to focus on countries that govern justly, invest in the health and education of their own citizens, and encourage economic freedom. And by focusing on those countries whose own policies encourage growth and lasting poverty reduction, the MCA will deliver better development results. And for those countries that do not initially qualify, it is offering a very, very strong incentive to adopt growth-enabling policies.

The MCA is based on a partnership in which developing countries, with a strong involvement of their own citizens, would set forth their own development priorities and propose MCA-funded activities. The MCA will insist on results. We will have business-like contracts with each partner. We will invest taxpayer resources only in well-implemented programs that have clear objectives and built-in performance benchmarks.

The MCA will promote economic growth in countries with good policies. The private sector will be a focus from the outset. And one of the criteria will really be having a healthy climate for entrepreneurship, including respect for private property and limits that rein in corruption. It is only with strong private sector growth that a country will be able to sustain, over time, investments in health, education and achieve other development gains.

The MCA will complement and not replace other forms of assistance. In fact, President Bush has sought to increase other types of

assistance programs, including those that focus on famine relief, HIV/AIDS or providing help for strategic partners.

MCA activities will be transparent, and they will promote accountability. The selection criteria, the board decisions, MCA contracts, and program evaluations will all be public and will be posted on the Internet.

To implement this radically new approach, the MCA must be administered by a separate corporation with a very focused mission. An independent Millennium Challenge Corporation with a high-level board will signal that the MCA partnerships are not business as usual. A lean Millennium Challenge Corporation would be 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, including the Secretary of the Treasury and the Director of the OMB.

The Secretary of State's participation will help ensure strong supervision and ensure coordination in foreign policy consistency. The Secretary of the Treasury, among other things, is going to make sure that there is consistency with our multilateral assistance policies and our foreign economic policies. And the Director of OMB, as a member of the board, can help ensure that the board implements the President's management agenda priorities of increasing and improving transparency, performance and accountability.

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

As the MCA improves itself, we expect that multilateral and other bilateral assistance programs will emulate many of its core concepts.

Madam Chairperson, I believe the MCA is the most important American assistance development initiative to be advanced in the last 32 years. 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.

We welcome the strong interest of the Congress, of NGOs and of the business community in the Millennium Challenge Account. We would encourage the committee to give the Millennium Challenge Act of 2003 its full support. And we pledge our cooperation in working with the Congress on this important initiative.

Thank you.

[The prepared statement of Hon. Alan Larson can be found on page 36 in the appendix.]

Ms. HARRIS. Thank you, Mr. Secretary.

Administrator Natsios?

STATEMENT OF HON. ANDREW NATSIOS, ADMINISTRATOR, UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. NATSIOS. Thank you very much, Madam Chairwoman.

I would like to submit my longer testimony for the record, if I could.

I would like to thank you and the members of the committee for holding this hearing on the MCA. For us in USAID, the Millennium Challenge Account is the most significant development initiative since the establishment of the International Cooperation Administration during the Eisenhower Administration. We subsequently became the U.S. Agency for International Development (USAID) under the Kennedy Administration 50 years ago.

The MCA will provide close to a 50 percent increase over current development resources and will firmly reestablish U.S. leadership in international development. I might add, with the $2.5 billion increase—we are already spending $1 billion on HIV/AIDS, but there is a $2.5 billion increase in bilateral assistance the President has proposed. So between the Millennium Challenge Account and that $2.5 billion increase, there is a 70 percent increase over three years in foreign assistance, which is clearly large. We actually went back in our historical records in USAID, which goes back to its roots in the Marshall Plan, and this is the largest increase since the Marshall Plan.

I want to make a second point, and that is that the MCA is a direct outgrowth of the single most important lesson coming out of USAID's experience, other donor bilateral agency experience, the World Bank and the U.N. agencies, and that is this: The single most important factor to successful development is a country's commitment to good policies that are conducive to growth.

Our experience has confirmed this year after year in country after country. And the fact is that it is not the quantity of aid that counts. No matter how much money you invest in a country, if the country has bad policies, it is difficult to make progress. At best, aid can play a supportive role. A country's commitment to help itself is a primary determinant of success.

If you have good policies and you invest money, you can accelerate the growth process and the process of developing sustainable institutions in the society.

This is the heart of the Monterrey consensus that was forged last year and which the MCA embodies by focusing on countries that have proven their commitment to good governance, investing in people and promoting economic freedom.

I might add that my own experience—and I have traveled to around 80 countries over the last 14 years since I have been doing this sort of work—my experience is personally that there are reformers in every country in the world. And in some countries, those reformers are in charge, driving the country, and those are the countries that are making substantial progress. In other countries, the reformers are in the parliaments or might be in the media or universities, but they are not at the center of events, and they are certainly not driving them.

What the MCA does, by creating this criteria, is to give these reformers a giant stick. And I can give you one example. I recently told a speaker of a parliament in a country that was doing very well in all the indicators except one. There were huge levels of corruption, and it was damaging the country's economic growth. I told that to the speaker. I said, "I have to be very frank with you. You

are not going to make it, because you just are not doing what is necessary."

I recently visited that country, in fact, a few weeks ago. I will not tell you the country; I do not want to embarrass them. And I asked the speaker when I met with him again. I said, "Have you made progress?" He said, "Well, we took what you told us, and we beat back the people who have been opposing the corruption reforms for the last four years. And the thing whizzed through the parliament, because everybody knows in the parliament and the government, and all the ministers, what the MCA is, and we want to qualify. And if that is what is preventing it, we want the reformers in charge instead of the people who defended the old order." So it is already having an effect, and the MCA legislation has not even passed yet.

The third point I want to make is that the MCA will complement USAID's own mission for the existing $10 billion bilateral aid program of the U.S. government. USAID has been and will continue to play a central role in President Bush's campaign to attack poverty by stimulating growth, promoting democracy and investing in people.

But as you know, USAID is only one piece of what is a much more complicated and diverse U.S. development strategy. We have different challenges now than we did during the Cold War, and there are many more actors involved in providing assistance. The MCA gives us the opportunity to articulate and implement a more coordinated strategy than we have had in the past.

The MCA will continue to assist a wide range of developing countries, but it will allow us to have what we think is a complementary relationship to the existing USAID bilateral program, which the President has committed will not decline as this Millennium Challenge Account increases in size.

The fourth point is that USAID will reorient its existing assistance programs to support and to take into account the principles driving the MCA. Basically what we are going to do is divide countries that we have presence in—and we have presence with USAID officers in 79 countries in the world—into four categories.

The first category is countries which we are investing in for purely geostrategic reasons. They are countries that are necessary to the protection of the United States' interests in sensitive areas of the world. And those countries are primarily and almost exclusively financed out of the Economic Support Fund (ESF) account, which is controlled by the State Department. We administer the programs with that money. But those are geostrategic categories.

The second is countries which just barely failed to make MCA status but want to make it. I recently met with a head of state in Africa. The country is doing very well in almost all of the indicators except a critical one. The head of state said, "Can we get help in correcting these problems so we will qualify the second year in this one area?" So we are going to refocus in those countries that almost made it but did not make it, and focus our attention on those weaknesses.

The third is in failed and failing states. We have a $2 billion program in countries that are not even close to making it. The Democratic Republic of the Congo has a central government, but it does

not control much of the country. There is no central government, and there has not been for 12 years, in Somalia. They are failed states or failing states, and we need to treat those in a separate category. But we will not abandon them. In fact, we have increased substantially the amount of money we are providing to those countries.

Then finally, there are countries that are not close to making it but we still have programs in those countries. We will work in countries that are not disposed toward reform in areas that we can work with nongovernmental organizations (NGOs) rather than through the government itself.

So that is how we will reorient our program.

Thank you very much, Madam Chair.

[The prepared statement of Hon. Andrew Natsios can be found on page 45 in the appendix.]

Ms. HARRIS. Thank you, Mr. Natsios.

The chair recognizes herself to ask the first question. This committee has an interest in the adoption of a provision of MCA that is currently before the IR Committee that improves the coordination and avoids the overlapping and duplication of efforts as we begin our bilateral and our multilateral aid programs and they start to interact.

Are you prepared to support these provisions, since we believe MCA will affect how we do business with our multilateral development banks and international financial institutions?

I would direct my question to Secretary Taylor.

Mr. TAYLOR. We are very supportive of making sure that the MCA interacts well and is coordinated with the Multilateral Development Banks and, of course, with USAID, as Andrew Natsios has indicated, and for that matter, with bilateral aid from other countries. And we are very, very supportive of any efforts that will help us do that.

I could say already we have actually done a lot to communicate. We have made presentations at the World Bank and at the other MDBs. Under Secretary Larson and I had a long session with the board of the World Bank. We are sort of in daily contact with the G-7 about what we are up to in this area. So I expect that there will be a lot of coordination and communication.

Ms. HARRIS. Excellent. Thank you very much.

The chair recognizes the gentlewoman, the ranking member of the subcommittee, from New York.

Mrs. MALONEY. I thank the chair for yielding.

After 9/11, President Bush worked very, very hard to bring the world community together with the United States to combat terrorism. And I truly believe—and he was terribly successful, wonderfully successful. And I truly believe that one of the reasons he was successful was because of the hard work of USAID, the State Department and all of our agencies in a multilateral way, our friendships with countries, the goodwill that we had spread.

And one of the things that I want to ask you is, how will this new account of bilateral aid impact funding of multilateral aid? In other words, will our multilateral aid contributions decrease with this new source of funding?

And I, for one, raised this question with Secretary Rumsfeld when he addressed Congress, because we are funding many, many organizations to go into Iraq. And it seems that it would be in our interest to let the United Nations in. I am not talking about the weapons inspectors, although I understand they are in now, but the humanitarian aid groups that are willing to go in and work with us. I would think, particularly from Arab countries that are our allies, to help our armed services, et cetera, to get them in there so it is Arab to Arab working so that you might be more successful.

Then there is also the aspect of burden-sharing of our economic dollars. We are galloping toward a $500 billion deficit. To the extent that we can get other countries to work with us, share the burden and work with us, it seems like a stronger approach.

So I just wonder, will this program in any way contribute to an American policy of decreasing our participation in the multilateral organizations that we have been funding, such as UNICEF, United Nations, UNFPA and others?

Mr. TAYLOR. Well, let me answer that question with respect to the international financial institutions.

Mrs. MALONEY. World Bank and IMF, too, yes.

Mr. TAYLOR. And then my colleagues will address the others.

I think right now we have asked for increased funding for our assistance to these institutions. For example, the IDA funding was an increase in the past.

And, in fact, what we have tried to do is make these contributions very consistent with the Millennium Challenge Account. The increase in funding we are asking for IDA for this year has a $100 million increment that is there to make sure that we get measurable results.

So it is an increase in funding. And President Bush always made clear that the Millennium Challenge Account was meant to be an increase over existing funding.

So it is certainly our intent to continue to support these other institutions. But, again, we want to be very specific. We are demanding a focus on policy, a focus on measurable results, because that is the only way the money is going to work.

Mr. FRANK. Would the gentlewoman yield for 10 seconds?

Mrs. MALONEY. I would always yield to the distinguished ranking member.

Mr. FRANK. Just to underline the importance of our markup next week, because the Under Secretary referred to IDA, and I just would remind people we have what I think is a very important markup next week in which I hope this subcommittee will endorse that request, send it forward to the Appropriations Committee, also for the other, I guess we have the African Bank and the Inter-American Bank.

So I just want to say that I hope we will be able to do that, and we have talked to the appropriators, and I am hoping we will be able to get that one squared away.

Mrs. MALONEY. Mr. Larson, where is the money going? Is it going directly to country governments? Or is it going to NGOs, local NGOs or U.S.-based NGOs working in eligible countries?

And who monitors how the money is being spent? Is the U.S. government going to monitor the money, or are countries going to send reports? What is the accountability in this aid program?

Mr. LARSON. One-sentence answer to your first question, as well: The same answer that Secretary Taylor gave on IDA and so forth would extend to the United Nations programs. And, in fact, we are looking to the United Nations to work with us on Iraq reconstruction.

On the money, the idea is that countries that have qualified—and this would only be those that have shown the strongest commitment to development—would come forward with project proposals which would be negotiated with very clear performance benchmarks. The actual Administration of a program or an activity would be something that would have to be built in.

In some cases, it may well be that USAID would be an implementing agency. It could be implemented by an NGO, but it would have to be something that was consistent with the country's development strategy. These are countries that are supposed to be committed to development, so we want to work with the countries and with their governments, even though the government may not be the administrating agency in every respect.

We are committed to a very high degree of accountability, which is going to require, of course, accountability from the country. But that has to be checked. And that would have to be checked with outside consultants, with auditors who are not only looking at exactly where the money is going, but also whether the results that we are looking for are actually being achieved.

Mrs. MALONEY. My time is up.

I just want to close by thanking Mr. Feeney for his really beautiful opening statement and the values he expressed in it. I agree.

Thank you.

Ms. HARRIS. Thank you.

Mr. Feeney, do you have any questions?

Mr. FEENEY. Well, I do.

And I want to thank the gentlelady. I don't know, the more I talk, I am sure, the more she will disagree with.

Mrs. MALONEY. I was surprised I agreed so much.

[Laughter.]

Mr. FEENEY. But, you know, I again am very pleased with the concept of reforming foreign aid. And I was also extremely pleased to hear Mr. Taylor suggest that productivity is the key. Ultimately that leads to higher consumption on a repeated basis, as opposed to one-time pump priming. And I am very grateful for the direction that you are going.

But as I look at the specific criteria, I am not sure that we have exactly articulated it the way I would. And I think that 435 members of Congress would come up with their own prescriptions.

I would like to have Mr. Taylor maybe comment on some thoughts.

As I look at this, I certainly agree that you cannot bail out bad policy with enough American taxpayer dollars, no matter where we are talking about in the world. And I certainly agree that inflation can be bad and deficits can be bad, which were two of your major criteria on the Economic Freedom Account.

But they are very easy to handle. I mean, inflation you can stop pretty quickly by deflating your currency. You handle the M-1 or the M-2 or the M-3 supply, you quit printing bills. The deficit is fairly easy to handle in most places. You just tax the people that are producing and working sufficiently, and ultimately you can wipe out a deficit pretty quickly in most countries, although I know developing countries are a little different.

But it seems to me that the recipe that you have put together here, when you combine that with the second major principles, which is investing in the public, the way to qualify 100 percent for principles three and four that you are trying to get here is to basically have 100 percent tax rates and 100 percent expenditure rates on education and health care. At least as I read the criteria that are set out here, that would be one way to comply.

And I think, going back to Mr. Taylor's ultimate goal, that we start with enhancing productivity in a county, what we really want to measure is the percentage of gross domestic product that is confiscated by the government and used not according to individual wishes, which would be the economic freedom that ultimately that you have laid out.

And so I am concerned that maybe some of the specific factors that we have talked about actually are undermining the ultimate. I would like to hear some descriptions there.

I mean, arguably, for example, public expenditures on health care, I am just guessing at this, but nations that have a higher percentage of private health-care spending and insurance probably have much better health-care records, life expectancies, et cetera, than nations that rely entirely on public health-care expenditures. I think you could make the same argument with respect to education. Legitimate home schooling in countries that have legitimate private and competitive systems actually have better public school systems.

So I guess I am a little worried, in terms of how we are actually going to apply all of this concept.

And then finally, I would ask you to deal with some of the—I was a little disturbed that, aside from the Millennium Challenge Accounts, we are increasing spending for nations that are abject failures under any criteria. And, again, we go back to charity is important, and we want to be charitable. But it sort of cuts against the grain of what we are trying to do with the Millennium Challenge Accounts.

And already, myself and my colleagues have referred to things other than productivity, going back to economic productivity as the be-all and end-all of ultimately enhancing the quality of life in developing nations. But we have talked today about the importance of family planning, reduced terrorist threats, democracy. And again, I argued that Hong Kong is probably the principal example of economic success, and it has had little or no political freedom, in terms of elections, over its brief history.

We talked about the importance of health care and public education. And of course, we have talked about, and I mentioned it myself, corruption within a government and our geopolitical interests. There are times when we simply want to buy favors from nations who are strategically placed.

So how this all fits together in a foreign-policy scheme is interesting to me. But the Millennium Challenge Accounts, itself, which we are talking about today, I think it is important that we develop criteria that are legitimately designed to create productivity on the front end.

And I want to, I guess, maybe just have—I have just been rambling, but if you can just respond to some of those thoughts.

Mr. TAYLOR. Yes, thank you very much for those observations.

I would say at the start—and, you know, we discussed all sorts of possible indicators and had lots of suggestions. And the points you are making are ones that have been on our mind.

There is a sense in which the indicators are objective, observable, they can provide input to the decision-makers who are going to make the judgments. So if there is a case which is even close to as bizarre as the one you indicated, where taxes are extraordinarily high and anybody could see would be defeating the economic growth, that would not be what you would be looking for, in terms of good policy performance.

There is an alternative, to just look at the fraction of government spending as a share of GDP. That is another measure. We considered that. Many different possibilities were considered. This one seemed to be—the budget deficit itself seemed to be one that brought things together as much as possible.

With respect to public expenditures, you are right, that is an input measure. That is why we thought this output measure was important to add to it. The focus should be on, really, the investing-in-people aspect, whether it is public sector or private sector.

So these are things which we think are good indicators. I do not want to indicate that they are not at all. But there is no indicator without some problems. But I think, as a whole, they work well, they are robust, they cover different areas.

With respect to the other reasons for foreign aid, which there are and will be, we have other sources of funding. This is an increase in funding over existing sources. And so this MCA is meant to focus on these areas. Humanitarian support, as Mr. Natsios has indicated, is a very important part of our foreign policy. So is our strategic issues. And maybe my colleagues want to address that.

But I think what we have got here with the MCA should focus on the growth and productivity, as you indicate. And I think it does that, considering all the different issues that we have looked at.

Mr. LARSON. Could I——

Ms. HARRIS. Mr.——

Mr. LARSON. I am sorry. I just want to make two quick observations on the congressman's questions.

One is that I think that some of the indicators in this last basket of economic freedom and supporting entrepreneurship are interesting and important ones: days to start a business, the free trade orientation, regulatory quality and the country credit rating, which is sort of a composite view of the doing-business characteristics of this country.

And then I think this is an attempt to give more weight than any other assistance program I know of to the factors that are friendly to entrepreneurial initiative.

The second point would be, we tried to do this in a way that no country would get in simply by being good in one of the three baskets. We have come up with a structure that emphasizes the importance of being a strong performer on economic freedom, a strong performer on empowering one's own people through education and health, and also a strong performer in the area of political freedom and governing justly.

And so the idea is to not have a country get in because they are a strong performer in only one or two of those areas.

Ms. HARRIS. Yes, Mr. Natsios?

Mr. NATSIOS. If I could just add a couple of comments. When we talk about whether foreign aid has been a success or not, we have to talk about which category of foreign aid. Are we talking about disaster relief? We have actually had remarkable success in preventing famines when they were sweeping across countries, and our assistance has, in fact, resulted in the prevention of mass starvation in many countries.

India has not, for example, had a famine since independence. And one reason was, in the 1960s, when they were faced with massive agricultural failure, there was massive amounts of food aid that went into the country from the United States. They are now a net importer of U.S. food commercially, because they liked our food so much that they now buy it.

And the type of assistance we have increased for failed and failing states is disaster assistance. It is to keep people alive. It is not to reform the economy. We are not under any illusions in those countries. But we are keeping people alive. We are reducing the child mortality rates, that sort of thing.

Secondly, in the category of social services, where we have put a lot of focus the last 30 years since the early 1970s, we have been actually very successful. The child mortality rates and health indicators right now in the developing world are the same as they were in the United States in 1950 and in Canada. So their rates now are what our rates were 50 years ago.

And the literacy rates in the developing world right now are what they were in the United States in 1950.

If you look at where the developing countries were in 1950, they have made enormous progress in the social services. The problem is, social services are important; but they are not sufficient to ensure economic growth.

All of the international institutions—the World Bank, the regional banks, the United Nations and all the donor aid agencies got out of doing two things, which, in my view, were a disaster: One area is they stopped doing agriculture. Beginning in the 1980s, mid 1980s, after Peter McPherson left as administrator of USAID, we stopped investing in agriculture. Two-thirds of the poor people in the world live in rural areas. They are farmers. If you do not invest in agriculture, there is going to be a lot of poverty in rural areas, and hunger. And there still is. We are now reinvesting in those areas.

Most developing-country heads of state will tell you, if they had a choice, they would not put money into places where we put money. They want more money in the rural areas where all their

poor people are, because those poor people are going to the cities now, and the cities do not have the infrastructure to accept them.

The second area we stopped putting investments in is infrastructure, particularly roads. You know, if you are a farmer and grow more surplus and you cannot move it, the food rots. So farmers do not grow surpluses because they cannot move what they grow out of the area and the village they are in.

That was another major mistake, because you cannot have industrial growth, commercial growth and agricultural growth without some kind of infrastructure, particularly in the rural areas.

Most of the people we talked to privately in countries that may qualify will tell you, "The first thing we are going to do is build more roads into the rural areas, because that is what we need to do our development."

Ms. HARRIS. Thank you, Mr. Natsios.

The ranking member of the full committee is recognized for questions, the gentleman from Massachusetts.

Mr. FRANK. Thank you.

I want to begin by expressing my appreciation for the remarks we have just heard from the Administrator of USAID. I think it was an important distinction that he made. Keeping children from starving is about as good a use of my time as I can think of. And the people I represent, if I take a small part of the taxes they pay to do that, I think they are happy. And I think our record as humanitarians, it is very important, and we ought to recognize the importance of doing that.

Secondly, I was very pleased to hear my former Massachusetts legislative colleague—back in the old days, we used to agree more there than people thought we might—talk about agriculture, because, you know, I am one who has voted in the past against some of the trade agreements. And when people have been critical because they say I am not supporting free trade, my answer is I voted against the agriculture bill. And I think, in voting against the agriculture bill, I took a stronger stand in favor of the right kind of trade than everything else put together.

And I think you have just underlined the extent to which our agricultural policy goes so counter to what we are trying to do, because when we subsidize our food growth, we undercut particularly what the Administrator was talking about.

I do have just a couple of questions. First, I did want to say with regard to the question the ranking member of the subcommittee asked about cooperation with the international financial institutions, I was struck to note, of the 15 criteria here, in 12 of the 15 instances, it is the World Bank or the IMF to whom you refer for the grading. So that does show, it seems to me, a good integration of those.

I also want to note, I am very pleased to have this threesome here. And maybe I am speaking against committee interest here, but one of the things that has bothered me with regard to the World Bank, the IMF, et cetera, is—and then we have foreign aid—we have got two different international economic policies. We have the State Department's international economic policy, with USAID basically aligned there, which deals with our bilateral assistance, and then we have our participation in the multilateral entities,

which is under the jurisdiction of Treasury. And I think we need a mix in both cases. I have felt that it was a shortcoming to have that kind of bifurcation.

So one of the advantages of this is, this is the first time that I can recall where we are talking about international economic activity and we have both State and Treasury here. And I hope we will build on that.

Now, just a couple of questions, and I raised this one before. Corruption is pass-fail—you absolutely have to pass on corruption—but civil liberties and political freedom is not. And that troubles me. You know, maybe because I grew up in New Jersey City in the 1950s and 1960s, and, you know, we did not get rid of corruption but we had political freedom. I am not sure, if we had been asked to do the tradeoff, where we would have gone. Although under Frank Hague, actually, they had neither, you may remember.

But why is that the case? And is there—I mean, some corruption versus no freedom, that troubles me. Mr. Larson?

Mr. LARSON. Well, thank you, Congressman, and I was beginning to get at your question in response to the last one.

In other words, a country is not going to rise to the top for consideration by the board unless it is above average in at least three of these governance criteria. And so we did that very deliberately, because we did not think it would be appropriate or good use of taxpayers' money to be supporting countries, even if they were the star performers in investing in their people and the star performers in terms of economic freedom, if they were not, you know, at least above average in these broad governance criteria. So they have to be above the median in at least three of them.

The corruption one, I think, is a very important one because it is so endemic. Corruption does undercut democratic institutions, as I know we all appreciate. It really saps the development success in the countries where it is endemic.

And it was the Administration's view that in a country that really was a poor performer on corruption that it would be impossible to have support for investment of taxpayer dollars and that we could not get the results that we wanted.

Mr. FRANK. I appreciate that.

Actually, it also gets at one thing that troubles me, and to some extent, as I read this, I get the sense that I am in Lake Wobegon where all the children are above average, Garrison Keillor's term. I mean, that does—what troubles me is that you could have people doing very well, but because they are not above the median that they could be in trouble.

And I would wonder why we could not have a more—but let me—one last question, then I will be glad to get the answer. And that is, when we talk about—one of the criteria is you cannot have a deficit, a three-year budget deficit. And I think we said 3 percent was the number, is that correct? I mean, how do we explain to them why this applies to them and not to us?

[Laughter.]

Yes, go ahead.

Mr. TAYLOR. Yes. On the deficit, this is an average over time. And it is meant to be what happens not just when you are in a

slow-down period, but when you are averaged across the cycle. So——

Mr. FRANK. Like, say, five years?

Mr. TAYLOR. Yes, it is meant to be an indication of overall fiscal stance, soundness over a long period of time.

Mr. FRANK. So, it does not just mean deficit. When it says deficit, that is——

Mr. TAYLOR. Clearly, when you are going in a slump——

Mr. FRANK. I mean, in other words—Okay. Because it does seem to me we are going to be ineligible. Lucky we do not need this.

But let me go back to the—if I could just get an answer on absolute versus grading on the curve. I mean, that is the troubling aspect.

Mr. LARSON. Well, we want to focus on the countries that have an overall policy framework that is going to get the best development return. I think Andrew Natsios pointed out that is the one big lesson that we have got, is——

Mr. FRANK. But question, what if we have a good—what if this succeeds and they all start getting good? Why do we then—are we going to run out of money? I mean, only half of them, are we sure that——

Mr. LARSON. If we are able to show extraordinarily improved developmental outcomes as a result of this approach, I think there would be a lot of us that would believe we should go to the Congress and say, "We are getting such extraordinary returns, we ought to be prepared to make larger investments." But we need to test this, and that is why we are beginning with——

Mr. FRANK. If Administrator Natsios could respond to this, because he seemed eager to.

Mr. NATSIOS. Yes, if I could. We would love to have this succeed so much that every country is going to be pushed into this account. I have to tell you, in my own experience, that is not going to happen.

The impediments to reform in most of these countries are as substantial as they are in the United States. The only difference is, we are already rich, so reform does not mean the difference between complete deprivation for the whole society and prosperity. In these countries, it does.

And this is the fact, this is the one statistic that is most disturbing, and I think goes back to Congressman Feeney's point about the failure of foreign aid. In terms of the elimination of poverty as opposed to social services, in humanitarian assistance, which is a different category, we have a poor record. All the donors do—all of the banks, the U.N. And why is that?

Since 1980, only one country has graduated from LDC status, the least developed country status. There are forty-eight of them. My first conference I went to after I took over as the USAID administrator was the head of the delegation to a conference on the least developed countries, which they have every 10 years.

The one country is Botswana. And they did not do it from foreign aid, although we had a big foreign aid program there. They did it from preventing the elite from stealing the revenues from the diamond mines, and using those revenues to build the country. In other words, it is a democratic country, they respect human rights,

it is a parliamentary democracy, it is well-governed, and they have relatively low levels of corruption. They took the diamond revenues, and they used the funds to develop the country. That is why they graduated.

No one else has graduated from the poorest countries in the world. If we have 15 countries, which is our goal to get into this program—and this is geared toward our criteria, the poorest countries in the world—if we have 15, which would be one-third of the LDCs, graduate, it will be miraculous. We will have made more progress than is conceivable under the legislation.

So, we only wish more countries would qualify, but I am not sure that is going to happen.

Ms. HARRIS. Thank you.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Madam Chair.

As one member who has had the benefit of traveling extensively in Latin America, I certainly applaud the goal of poverty reduction, because if you truly want to see some real poverty, there are places in Latin America where you can see it.

Obviously, though, and I do associate myself with my colleague, Mr. Feeney's, comments that historically there seems to be a very poor correlation between poverty reduction and U.S. aid. So, first, I would certainly like to applaud the Administration for this initiative, for actually trying to tie aid to demonstrable policy changes. I do believe the world works off of incentives, so, to incent these people to engage in better policies that will lead to poverty reduction is a noble goal.

I have several questions that I would like to ask. One is, I believe on your indicators of encouraging economic freedom, one is trade policy. It takes two to trade, so I am curious, what proposals or initiatives does the Administration have to increase trade with potential MCA nations?

And I am not sure who is best qualified to answer that question. Perhaps we will start with you, Mr. Taylor.

Mr. TAYLOR. The measure of trade that we have included is the country's openness to trade, the country's reduction in trade barriers.

Mr. HENSARLING. No, I understand that, but my——

Mr. TAYLOR. And that is, of course, important.

One of the possible ways that the funds could be used is to improve capacity to trade—port facilities, airports, things like that. That is very much, in the sense of capacity building, could be a source or a use of some of these funds. And we will very much be supportive of that, if that is what countries want to do.

In the meantime, of course, we have other trade initiatives. For Africa, we have the African Growth and Opportunity Act. We are moving with free trade agreements, et cetera.

Mr. LARSON. Congressman, if I could just add one quick point.

We are in the midst of the Doha development agenda, the WTO round that has a specific focus on development. And it is particularly important for all of the countries that could be beneficiaries in this program for that to succeed. Because multilateral trade liberalization is the most important trade tool we have. Seventy per-

cent of the duties that developing countries pay on their exports, they pay to other developing countries.

So, we believe these preference programs such as the Africa Growth and Opportunity Act are important, but we also believe that it is very important, in order to stimulate development, to achieve a global trade-liberalizing agenda on manufactured goods and on agricultural products, as well as services.

Mr. HENSARLING. Several Congresses ago, we passed welfare reform. It has been a hugely successful program in moving people off of welfare checks and onto paychecks, moving people off of lives of dependency into lives of independence and self-respect. And I think there is an analogy here. Part of what we did was tie welfare receipts to behavioral changes, but another thing we did is put a time limit on welfare.

I am curious, given that once again my observation is that the world tends to work off of incentives, why would an MCA nation not, perhaps, the regime, be incented to make very, very small progress and string along their aid for a very long time, as opposed to eventually weaning themselves off of that aid? Is there any contemplation of a time limit for MCA assistance?

Mr. LARSON. We definitely want to keep the incentives right. And we have been very clear that specific activities under the Millennium Challenge Account would be time-limited. In other words, we would want to build into any project or any activity a beginning period and an end date at which point the country could undertake any further responsibility that is necessary to make that project or activity succeed.

Mr. HENSARLING. I will ask my last question, since I see my time is running out. Obviously, the two greatest challenges that I would observe in these countries in working their way out of poverty has to do with their policies and corruption, although I am not exactly sure how one gets their arms around corruption.

For example, in our country, and I think we have had the Secretary of HUD testify before this committee, two years ago, HUD lost 10 percent or $3 billion, of their budget in overpayments. Is that a facet of corruption? In addition, we have the GAO who cannot certify 22 out of 26 major department accounts.

So, if we cannot figure out where all the money is going in our government, how are we ever going to figure out where all the money is going in these governments?

Mr. TAYLOR. Just very briefly, Congressman, there is a significant matter of degree here. If you take, for example, in many developing countries which you know where just to move goods down the road, across the border or around borders, there are checkpoints, there are people checking there, taking their charges, and that is a significant barrier to commerce and to trade. But it goes on and on like that.

It is an order-of-magnitude difference. And nobody is perfect, by any means, but, you know, seriously, this is a very great impediment to development in these countries.

Ms. HARRIS. Thank you.

Oh, I am sorry.

Mr. NATSIOS. We have evidence that the countries that have the highest levels of corruption are not only not making progress, they are regressing.

There is one country in Africa that is very rich, potentially, and 25 percent of the national income of the country is missing from the national treasury, and that is not from bad accounting. That is a World Bank estimate. The country itself could not possibly tell you how much is missing because they do not have accounting systems to do it. The bank had to go in and do their own audit of it.

The difference between what you are talking about and what we are seeing there is not because human nature is any different here; it is not. I keep telling heads of state all over the world, Americans are no different than your people are. The difference is we have a whole set of powerful institutions that mitigate against fallen human nature in the American system. And that is what prevents the abuse from getting out of control.

In many of these countries, there are no institutions that control corruption. The inspector general exists, they call it the general audit authority, but has no power at all to do anything. They do not even have any auditors, in many countries. And there is actually no way to prosecute the offenders. The courts do not function. No one ever gets indicted for corruption, in many of these countries.

If you do not have even the minimal set of institutions, you will not control corruption, it gets completely out of control, it is part of the system, it is expected, everybody takes bribes.

None of those things are true in our system. We have our scandals, as do the Western Europeans and the Canadians. That happens, but we have systems for controlling it. And that is what many of these countries need to establish, strong institutions to deal with fallen human nature.

Ms. HARRIS. Thank you.

The gentlewoman from California is recognized.

Ms. LEE. Thank you, Madam Chair.

Let me first say that this, the MCA proposal, I believe we are marking up in International Relations this week, and I serve on it, the International Relations Committee. And since it has been introduced, of course, I have had many, many concerns about it.

And I say this, starting with the fact that once we learned that the Heritage Foundation and, I believe, the Freedom Fund had developed, for the most part, the criteria, this raised concerns with many members of the Congressional Black Caucus, because these two organizations do not reflect the diversity of thought in America, in terms of criteria that could or should be developed with such a magnitude of a program as this with taxpayer dollars.

So having said that, I just want to say to you that we have been looking at this very carefully, and so I welcome your testimony today.

And one of the areas that we have been concerned with, myself and many members of the Congressional Black Caucus, is the role of the United States private sector. What exactly is that role?

I noticed in your testimony, Mr. Larson, you talk about possibly evaluations, technical assistance, auditing, monitoring. What exactly does the U.S. business community see, or how do you see this

as it relates to the U.S. business community and where the connection is?

Mr. LARSON. Thank you.

With respect to your first comment about the indicators, what we have tried to do is go into the public domain for the best available public indicators so we could have the degree of transparency that we think the Congress and the American people would like. Most of these indicators were ones that are done by the World Bank Institute.

There are some that where the best indicator of what we were looking at, like trade policy, we felt, came from an institution like Heritage House. We did not take it because of their political orientation. We took it because they had a good, publicly available indicator of trade policy.

On the U.S. private sector, my sense is that there is strong interest and support from this from many of our businesses. Not because they see immediate opportunity, because many of these countries are very, very poor and where, at least in the short run, there are not going to be significant opportunities. But I think they do see an approach that they like, an approach that sort of marries compassion and a commitment to results and to accountability.

I think that we may find that when we are trying to measure and assess results, that we may, you know, we want to have the freedom to go to all sorts of contractors, whether it is NGOs, businesses, accounting firms, international organizations, to sort of help us assess what our successes or failures are.

Ms. LEE. In doing that, let me ask you, because I know the point is to fast-track a lot of this in terms of the board and the CEO having that kind of authority, how are you going to ensure that when you do go out in terms of going into the private sector, that there are non-discrimination aspects of the contracting procedures, that there is outreach as it relates to minority and women-owned businesses?

I mean, how is that piece going to be secured in an operation such as this that is new and quasi-governmental, quasi-private. It looks like you do not have to comply with United States guidelines, as it relates to minority and women-owned business contracting.

Mr. LARSON. We want to have this organization be a model of transparency and flexibility. I think that, among other things, will mean using the Internet to disseminate very, very widely opportunities for contractors to provide services.

We believe that by focusing largely on subsidy here in Africa and the poorer countries of Latin America, we are going to find that there are many Americans who have links to those countries that will have very, very strong comparative advantage in bidding for these contracts or services that are required by the corporation. There is going to be a strong interest in reaching out to those people, because they will be in the best position to provide the services required.

Ms. LEE. But aside from Internet access, I mean, how do you plan to do that? I mean, Mr. Natsios could tell you in terms of the lack of participation of minority firms in USAID contracting, and they have to comply.

So what is it that you are going to do to make sure that the outreach, the technical assistance, the inclusion is there, rather than just posting it on the Internet and say, "Go for what you know."

This is a good—I will not say a good old boys' network of firms out there, but this is a culture that is difficult to penetrate for women and for minority-owned businesses.

And with an initiative with this much money involved, where there is a chance that contracting with U.S. companies will take place, what is it that you are going to do to make sure that access is provided, other than providing it on the Internet?

Mr. LARSON. Well, again, one of the reasons for setting up a corporation that is different is to get fresh thinking about how to accomplish all of these things.

I stress the transparency in the Internet aspects, because I think it is one of the most obvious tools.

We are at work now trying to develop options for the types of management issues that you are raising. How can this corporation do innovative, flexible, effective contracting and reach out? How can it have a personnel policy that is flexible and results-oriented?

I mean, this is some of the administrative and managerial spadework that the Administration is doing right now, as the Congress is considering authorization——

Ms. LEE. But will you be required to comply with existing law and regulations with regard to this, or not?

Mr. LARSON. The Administration has proposed to have flexibility on contracting so we could go out and get the services at the best possible price and with the best possible——

Ms. LEE. So the answer is no. You can——

Mr. LARSON. Well, I am trying to tell you what it is that we are looking for.

Ms. LEE. Yes, that is what I am asking you.

Mr. LARSON. And——

Ms. LEE. You do not have to comply with current, existing laws, as it relates to the utilization of minority and women-owned businesses.

Mr. LARSON. We would propose to do that through the sort of outreach efforts that I was just describing.

Ms. LEE. So, you do not have to comply. Okay. I am trying to get a handle on that, and it has been very fuzzy up until now. But thank you for stating it very clearly.

Ms. HARRIS. The gentleman from Minnesota is recognized.

Mr. KENNEDY. In reference to the ranking member's comments about Lake Wobegon, I am pleased to be the official representative of Lake Wobegon.

[Laughter.]

And yes, all of our children are above average, though a prior Kennedy chose to address international development and exporting those above-average children from Lake Wobegon as part of the Peace Corps. And I think this a great step forward to export the principles of what we stand for in Lake Wobegon and across the country, to try to get others to embrace those, because those principles have, indeed, been so successful for us.

And I think I would also agree with the ranking member that there are few more important things we can do than try to address

the needs, in this case, of people in your initial sample that have a per-capita income of $1,425. I mean, these are people that are really in need.

And I think this does leverage—if it is successful, this can hopefully influence the way that the international bodies are addressing economic development and our other examples to try to leverage the successful track record that embracing the free markets, embracing open economies can really result in.

I have a couple of criteria questions, though. The first one is, if you read the founding of our country in the Federalist Papers, and James Madison, he highlighted the importance of property rights to begin any real economic development. And although, you know, we have a couple of bankshots here toward property rights, I do not really see it listed as one of the criteria that needs to be preserved.

Mr. TAYLOR. The property rights are certainly essential. Rule of law, property rights go together. The indicators that we have under the civil liberties and political rights do emphasize the rule of law. And, of course, the control of corruption relates to property rights, as well.

So, it is definitely part of these measures in a number of different ways as you look through them.

Mr. KENNEDY. Okay. And I would just encourage that, you know, we maybe look at that as being a bit more central and a bit more stated as part of those criteria. You can have a rule of law that still has a law that ignores property rights. And I think we need to make sure that we keep that central, given how important that is.

Another key concern to us, particularly on the Financial Services Committee, is to make sure that there is a solid banking in a system that is out there, that is honest, that is sound, that is providing what it needs to the private industry, the entrepreneurs, to go. And do we feel confident that, again, the criteria we have established ensures that that is being encouraged to be developed?

Mr. TAYLOR. I would say that is an area which we always focus on in our relationships with other countries, and the IMF in particular looks at that with their financial-sector assessment programs.

There are some regulatory measures that are developed by the World Bank Institute. It is in the encouraging economic freedoms, called Regulatory Quality Rating, and it is an indicator that includes many—it is an aggregate of other indicators.

I believe if you combine that with the credit rating index—the credit rating index is measuring financial stability to some extent. It is also fiscal stability. But the people who look at the credit rating will, of course, be looking at the soundness of the banking system. It is a very important part of a credit rating for a country.

And one of the economic freedom measures we have is the country credit rating developed by Institutional Investor Magazine. So, those are a couple of ways where that factor comes into play.

But that is going to require, I think, continued emphasis, because even countries that are not so poor still have improvements to be made in their financial sector.

Mr. KENNEDY. And, Secretary Taylor, in your submitted testimony, you listed the criteria underneath each of the categories. And as I went through "investing in people" and "encouraging eco-

nomic freedom" criteria, there was always an objective published data that could be used to develop that. As I go through the "governing justly," no sort of existing indexes that are published and available were cited.

Is that something we are creating, those indexes, or are we looking at outside entities to provide those?

Mr. TAYLOR. The "governing justly" indicators are actually all available publicly. Freedom House does the two indices called Civil Liberties and Political Rights, and those are published annually. They have a nice little paperback book you can get out and look at the descriptions for each country, plus it is on the website.

Now, the World Bank Institute developed the other four indicators, and those are also publicly available. Those four indicators are, in turn, based on lots of other measures that are put together by other agencies and other research firms, other surveys. But those are all publicly available. In fact, they are all on the websites right now.

Mr. KENNEDY. That is great.

And I just want to follow up on Congressman Feeney's concern about the health expenditures. When we say "public expenditure on health," does that mean just government spending on health? Or does that mean with the private sector spending on health in addition?

Because, you know, when we talk about people are acting the way they are incented to act, I do not want to encourage people to have a single payer in a government health plan that certainly a number of us would not support, and have that be exported because of this criteria to other countries.

Mr. TAYLOR. The measure now is public sector as stated. What we were looking for is good measures of a country's intent to invest in people. When we get more and more data, perhaps some of these could be refined and revised.

And I would also say that it is not just the expenditures, it is the results, those immunization rates, for example, that we focused on, and the completion rates for schools. So, it is not just the inputs, it is the outputs.

And, finally, I would emphasize that the judgment about the country's qualification is going to depend on these indicators, but also taking other things into account. So, for example, if there is some missing data, some judgment will have to be applied.

Also, if you are in a situation where there is a clear intent, maybe measured by private-sector development of health, that is very significant in a country, and for that reason the public expenditures may be lower, that would be exactly the kind of thing that the Millennium Challenge Board would take into account.

Mr. KENNEDY. Now, you talked about judgments, you talked about potentially revising these criteria over time. What role would you see Congress having, in terms of oversight in providing input as we go through this with the Millennium Challenge?

And will there be an inspector general that MCA will have, to help make sure that these criteria are being applied and that we are being rigorous in our approach?

Whoever wants to answer that.

Mr. LARSON. There will be an inspector general. The Administration is still considering whether it should be USAID's inspector general or a different inspector general, but there will be an inspector general.

And I do think that—I know that Secretary Powell and I am sure that Secretary Snow would feel the same way. We expect to have very strong accountability to the Congress and oversight to the Congress for the results that we are achieving, and that the CEO will be someone who will want to work with the Congress.

I think it is very important what Under Secretary Taylor was stressing. At the end of the day, the Cabinet-level board is going to take all of this information into account, and then make its best judgment on recommendations to the President about which countries really meet the underlying criteria of governing justly, promoting economic freedom and investing in their own people.

And that board, that Cabinet-level board, will be accountable to the President, accountable to the Congress and accountable for the results that they are achieving. And that will entail any revision of these indicators, which are tools but not a replacement for the judgment of the board.

Ms. HARRIS. Thank you.

The gentlewoman from California is recognized.

Ms. WATERS. Thank you very much. And I am sorry that I was not able to spend more time here. We have so many conflicts in scheduling. But I did want to come to show my interest.

The one, I guess, major concern that I have, as I look at the makeup of the board, is the absence of USAID. What role will USAID play with this board?

Mr. NATSIOS. I report to the Secretary of State. I go to Colin Powell's morning meeting at 8:30 every morning. He is our representative on that board. So we have a representative, and he is the Secretary of State, or she, depending on the Administration.

We expect, in the field, that if an MCA country is chosen and there is a USAID mission in the country, that USAID will be called on by the MCC corporation to help administer the program. But that is a decision that will be made based on the country in particular and the decisions of the board.

Ms. WATERS. Am I correct in understanding that USAID has been the lead, historically, with these kinds of decisions?

Mr. LARSON. In foreign assistance, the responsibility is divided. The Treasury Department handles the international financial institutions. In other words, our assistance that goes through those institutions is handled by Treasury.

Except for the World Food Programme, most of the U.N. agencies that get money from the U.S. government get it through the State Department. The State Department also has an account called the ESF account.

I would say that maybe 60 percent, 55 percent of the foreign assistance program of the U.S. government has been, historically, in the last 20 years, handled by USAID, and the other 45 percent by either State or Treasury and now some by HHS. So, it is divided.

Ms. WATERS. Am I to—I have always understood that USAID, being involved on the ground, interacting with nongovernmental organizations, have an intimate knowledge of how things really work

in many of these countries, and that is the kind of information that has helped us make some decisions about financial assistance and funding.

How do you anticipate having that on-the-ground, interactive knowledge communicated to and acted on by this board?

And do not tell me the Secretary of State, because I recognize that is your boss.

Mr. NATSIOS. Sure.

Ms. WATERS. But I also understand that he gets his information from the bottom up, and that he really cannot make decisions unless he knows what is going on on the ground and that the combination of work that is done by our embassies and all of that personnel and USAID—my husband was an ambassador, so I understand that very well.

Now, so, how will they get this information?

Ms. HARRIS. Could I ask the gentlewoman if she would yield a moment?

In the latest information that we have, the USAID will be represented on the board.

Ms. WATERS. I am sorry, what did you say?

Ms. HARRIS. In the information, USAID will be on the MCA board.

Ms. WATERS. Why doesn't he know that?

Ms. HARRIS. I am not sure if he is——

Mr. NATSIOS. There are some things I know I do not say, Congresswoman, because they are decisions of the Congress that have been made, but Congresswoman Harris has said this, and that is a decision of the Congress.

The way our legislation was submitted, the USAID administrator is not on the board. But there are——

Ms. WATERS. Oh, but you are saying that you are going to be active in helping to make sure he is on the board.

Ms. HARRIS. In the information that we received that will be presented in the markup, USAID is on the board.

Ms. WATERS. I see. All right. Thank you very much. Just wondering.

Ms. HARRIS. Great question.

Well, I want to thank the members of the panel, Secretary Taylor, Secretary Larson and Administrator Natsios, for participating today.

I understand that the chair notes that some members may have additional questions that they wish to submit to the panel in writing. So, without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and place their responses in the record.

This hearing is adjourned.

[Whereupon, at 11:52 a.m., the subcommittee was adjourned.]

A P P E N D I X

June 11, 2003

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Domestic and International Monetary Policy, Trade and Technology

"Matching Capital and Accountability— The Millennium Challenge Account"

June 11, 2003

This morning, we will hear from several distinguished leaders from the Administration who will explain how the President's new Millennium Challenge Account, the MCA, will change the face of international development assistance.

Treasury Secretary John Snow appeared before the full Financial Services Committee in May to detail the Administration's international economic agenda. The MCA was prominently mentioned in his testimony. I look forward to having today's hearing participants flesh out the ideas with some specific examples.

The new program is aptly named. Make no mistake about it, helping eligible countries help themselves is a challenge. It is a challenge for countries to improve their governance, their economic freedom, and their investment in human potential.

Successful societies cannot are built on good leadership, on economies based on sound market principles, on health and education services.

So, with the MCA, we seek to build on our other bilateral and multilateral aid programs. This is an interagency corporation concept that provides transparency and accountability, without creating a bloated new bureaucracy. It relies on expertise from the Departments of Treasury and State, as well as the Agency for International Development. I understand the Office of Management and Budget will assist as well.

The Challenge is not just extended to applicant countries, but also to our government as we guide this process forward. With jurisdiction over the Treasury Department, international finance, and multilateral development banks, I am particularly concerned how coordination is undertaken so that duplication of efforts or, overlapping is avoided.

Like any sound investment strategy, the MCA is based on a long term outlook. The President takes a positive step forward by proposing $1.3 billion for the MCA in its first year and ramping up to $5 billion by its third year. Congress will be very involved in this process.

The MCA includes sixteen performance indicators to gauge how serious the countries are about ruling justly, investing in their people, and promoting economic freedom. These indicators include regulatory quality, political rights, and public expenditures on health and primary education.

These are long-term solutions and goals, but with the leadership of an MCA Corporation, applicant countries should make progress toward strong civil societies and sound, market-driven economies.

Thank you all again for your testimony today. I look forward to your comments.

Testimony of Alan Larson
Undersecretary of State for Economic, Business and Agriculture Affairs
on the Millennium Challenge Account
before the House Subcommittee on Domestic and International Monetary Policy, Trade and Technology
June 11, 2003

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

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 - making $5 billion more per year available 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 poverty reduction. It targets assistance to those countries that have adopted the governance, social and economic policies that enable growth and lasting development. It recognizes private sector growth as critical to sustaining health, education and other development gains and thus emphasizes a healthy climate for entrepreneurs, including respect for private property, limits on corruption, and a functioning financial system. The MCA increases the odds of spurring economic development with partner countries and, at the same time, encourages more countries to adopt growth-oriented policies.

- The MCA recognizes that development success is driven by a country's own efforts, policies and people. We can support and encourage sound efforts, but we cannot substitute for

genuine commitment to take the hard steps needed. The MCA thus proposes a true partnership in which the developing country with the participation of its citizens establishes its own development priorities and plans.

- The MCA demands accountability and results. Each successful country proposal will include clear development objectives and benchmarks. Meeting these benchmarks will be key to continued funding.

The MCA builds on the reality of the global economy, and the success of democratic institutions. It recognizes our responsibility and opportunity to help good leaders deliver on the expectations of their people. The MCA is optimistic, yet practical, about the potential of people in poor countries to chart a course to peace and prosperity with effective support. In that, it is all American. 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 5, 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, and a number of other entities. We have also benefited greatly from the strong interest and suggestions of many. The public, especially the NGO and

business communities, have made important suggestions. 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; and
- 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.

How the MCA Would Work

Mr. Chairman, to make this vision a reality, the Administration 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." This innovative approach requires new thinking and new ways of doing business that can best be introduced through a new, high-profile entity. Establishing the MCC as a government corporation with a high level board will signal that MCA partnerships are not business as usual. What we are proposing is new ways of working with very strong partners and a laserlike focus on achieving sustainable results, engines of growth and models of success where track records and lessons learned are clear to see. MCA

partnerships will be based on a high standard of mutual responsibility at the upper reaches of both governments. The MCC will use the most modern and effective approaches possible. It will combine an unprecedented level of country selection rigor and accountability for results and effectiveness, with a high degree of operational flexibility. We also expect that the Board and the MCC CEO and staff will want to consult closely with Congress on the progress and activities under this innovative new initiative.

The MCC will build on development lessons-learned. It will also draw in outside expertise and oversight on an ongoing basis, tailored to the issues, countries and sectors of practical concern. We expect US development expertise, including the experience of the US profit and non-profit sectors in establishing transparent, financially accountable, effective activities, will be engaged through the MCA. We expect as well to see local for-profit and non-profit entities working side by side with the governments and other US participants. The MCC is will support developmentally sound country proposals and work carefully with MCA partners to identify those most likely to implement effectively and to build capacity within MCA countries.

A Chief Executive Officer appointed 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. The Secretary of State, as Chairman of the Board, will exercise strong supervision of the CEO of the MCC and ensure coordination of assistance and foreign policy consistency. The Secretary of the Treasury would ensure consistency with our multilateral assistance and our foreign economic policies. The Director of OMB, as a member of the Board, would help the Board implement the President's Management Agenda priorities of improving transparency, performance and accountability in the new Corporation.

To be most effective in promoting development, the MCC will need flexible authorities with regard to personnel, funding, procurement and contracting. 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 goods and services with the private sector, with government agencies, and with international

organizations and should be able to procure globally. To be able to respond to individual MCA country proposals, the MCA should not be restricted to specific areas of funding.

Selection: The MCA process begins with selection of qualifying countries. The eligible pool of poor countries would expand each of the first three years as MCA funding ramps up. Only the 74 countries eligible to borrow from the IDA with a per capita income below $1,435 would be considered the first year. In FY 2005 the pool would extend to all countries with incomes below $1,435, adding approximately 14 countries. From FY 2006, all countries with per capita income below $2,975 (low middle income countries) would be included, adding another 30 or so countries. The per capita income ceilings and country measures are taken from the World Bank and would be adjusted annually. Countries ineligible to receive aid under the Foreign Assistance Act would also be ineligible for the MCA.

Once a year the MCA would run a competition among the eligible countries to determine which qualify for the MCA. Qualification is based on 16 indicators measuring country performance in the three areas of ruling justly, investing in people and encouraging economic freedom. Countries that do better than the median on half the indicators in each of the three categories and on the corruption indicator would nominally qualify. Because scores relate to income, countries below $1,435 and those between $1,435 and $2,975 would compete separately in the indicators and selection process. Countries that qualify in the first year will not lose eligibility simply because of median changes caused by the expansion of the pool in subsequent years.

To ensure that each qualifying country is a committed development partner that meets the President's three core criteria, the MCA Board would review the results of the indicators portion of the selection process. In exercising this responsibility, the Board would take into account material information, such as trends in leadership or corruption and other recent developments. On that basis, the Board might include a country that just missed or exclude a country that "passed".

The selection process will be transparent. Transparency provides the information necessary to give poor countries incentive and direction to develop the required policies and to ensure MCA accountability. Sources for the indicators and the data for evaluating them will be posted on the MCA website.

Board decision-making will also be transparent to Congress and the public.

The indicators come from independent and analytically rigorous sources, including the multilateral development banks, academic policy institutes, international financial institutions and non-profit organizations. Data is also solicited from national sources for budget indicators to update publicly available information. The MCA will regularly review the indicators used to help select qualifying countries. Indicators may be dropped or 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 MCA Contract: The implementation phase will begin after countries have been notified of their selection to the MCA. To implement the partnership between the MCC and specific MCA countries, the MCC will use time-limited, business-like contracts that set forth 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, drawing on their development strategy as reflected in their Poverty Reduction Strategy Paper or other development planning document. We will be seeking MCA country contract proposals that engage every element of an economy - government, civil society and business. The MCC will stipulate that all country contract proposals be the result of an inclusive domestic consultative process and each MCA country will identify its priority development hurdles and a program for addressing them through such an inclusive process.

The proposal should focus on a limited number of clear measurable goals critical to economic growth and development. For example, a country might decide to focus on improvements in one or two areas, such as agriculture, education, enterprise and private sector development, governance, health and trade and investment capacity building. The proposal must 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

MCC and the MCA country, the role of civil society, business and other donors, and a plan for ensuring financial accountability for funds used.

The Millennium Challenge Corporation will consult with the country at every stage of the process and provide technical assistance as necessary. The MCC will review the proposal and conduct both sectoral and country evaluations, which may include government and non-government experts from outside the MCC. Selection as an MCA country alone will not guarantee automatic funding of all aspects of a country's proposed contract. The MCC may ask questions and propose modifications to the contract proposal. The MCA Board will exercise final approval of all contracts. Contract terms will be made public in both the United States and the MCA country.

The MCA contract will also be key to how the MCA is implemented in a country. The method for disbursement of funds and selection of implementing agents, for example, may be determined in the MCA contract. The MCC will disburse funds in the most efficient manner to the implementers of MCA activities. We expect our own private sector and development experts will participate and bring to bear their skills on everything from financial management and auditing, to ensuring that education programs leave no child behind.

Monitoring and evaluation to ensure accountability for results will be an integral part of every activity for which MCA funds are used. The MCC will monitor activities and systems to ensure financial responsibility and accountability for MCA assistance. It will review overall budget data to demonstrate that MCA resources and domestic and other development resources are used in a complimentary manner. It will conduct audits to ensure that data reported by recipients is accurate and complete. It will monitor achievement of specific benchmarks for measuring progress toward program goals. And, the MCC will evaluate whether MCC assistance is achieving sustainable results. The MCC will conduct monitoring and evaluation directly and through independent contractors with professional auditing expertise. All evaluations would be made public.

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

benchmarks. On the other hand, funding could be increased if countries reach or exceed performance targets and have included "incentive clauses" in their contract. At the conclusion of the contract period, MCA assistance will end unless participant countries that have performed successfully submit a new proposal and renegotiate a new contract with the MCC.

Operations: 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 could implement some MCA programs. In fact, USAID programs will work in partnership with the MCA to provide technical assistance and funding for those countries that are "near qualifiers," so that they can make the policy changes necessary to qualify for the MCA. We hope that the work and resources of the MCA, which add to existing development assistance, might even help free up other development resources to make more progress in non-MCA countries.

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 core US development assistance over 2001 levels, 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.

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. As the MCA proves itself, we expect it to influence how multilateral and other bilateral assistance programs are designed and conducted.

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 support of the "Millennium Challenge Act of 2003."

TESTIMONY OF ANDREW NATSIOS,
ADMINISTRATOR,
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)
ON THE MILLENNIUM CHALLENGE ACCOUNT
BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
WEDNESDAY, JUNE 11, 2003

Thank you Chairman King and Members of the Subcommittee for holding this important hearing on the Millennium Challenge Account (MCA). We appreciate your interest in this legislation, and we look forward to close cooperation with you and your subcommittee as we move ahead to establish what I believe is a revolutionary new development 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 noting 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. In February, 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. The MCA is the direct outgrowth of what USAID and other development actors have learned over the past fifty years. We not only have considerable first-hand experience about what has worked and what hasn't, but we also have the benefit of considerable recent analysis by the World Bank and leading analysts that support this experience. Put simply, economic development assistance in poor countries works best when you are pursuing good policies that are conducive to growth. We know that good governance, policies and institutions are key; real country ownership is also essential. And we know that performance must be measured using rigorous and unbiased indicators. These are the foundations for the MCA.

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

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

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

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

To be sure, some East Asian states have contained corruption and achieved rapid development under authoritarian rule. But worldwide, these states have been the exception. Over the past two decades, the two most rapidly developing countries in Africa have been the only two African states to sustain democracy continuously since independence, Botswana and Mauritius. Recent research shows that institutions and policies explain most of the variation across countries in economic development, with property rights, control of corruption, civil liberties, and political rights all significant factors accounting for development success. It has been found that at every level of national development, fewer infants die in democracies than in dictatorships. But actually linking aid to development performance is a radical step. This is one of the reasons why MCA marks a revolution in foreign assistance. Because MCA countries and institutions will have demonstrated capacity to achieve results, the new Millennium Challenge Corporation (MCC) will be able to employ a new way of doing business that relies on host country institutions to manage development activities.

RELATIONSHIP TO USAID

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

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

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

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

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

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

that need post-conflict, transition or humanitarian assistance; and (4) countries requiring assistance for strategic national security interests.

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

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

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

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

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

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

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

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

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. In short, it will likely vary considerably from country to country.

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

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

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

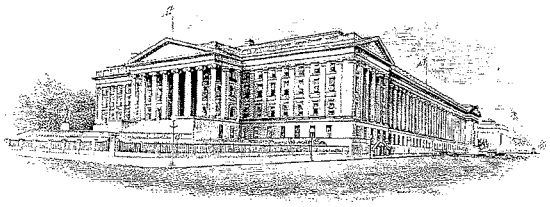
USAID presence in the field has rightly been repeatedly recognized as its strongest suit. Thirty years of development experience has taught us that country context matters a great deal. I can imagine that our very capable field Missions could provide critical support to the MCC, helping to work with local partners, finding creative, local solutions to problems, and generally facilitating the work of the MCC. The basic USAID activity in many of the likely MCA countries has been knowledge transfer and building local capacity and institutions. In some cases, continued USAID programs in institution building may be necessary for a time to further build country capacity to manage MCC programs and resources. As I have tried to emphasize, while I believe USAID will have a key role in supporting MCC programs, we do not want to adopt a black or white approach to how USAID will relate to the MCC in every country; rather we think each country will need to be reviewed on a case-by-case basis.

CONCLUSION

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

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

For USAID, the MCC has the potential to provide a great model. It is a golden opportunity to prove that development, done right, can work. I urge your favorable consideration of the legislation and thank you for the opportunity to testify.



DEPARTMENT OF THE TREASURY
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Contact Tony Fratto at 202-622-2960.

Treasury Under Secretary John B. Taylor
Testimony before the House Subcommittee on Domestic and International Monetary Policy, Trade and Technology of the House Financial Services Committee

Chairman King, Representative Maloney, 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 within the Administration's overall approach to economic development.

Today there are more than three billion people living in extreme poverty. Last year 3 million people died for lack of immunization, 1 million died from malaria, 3 million died from water-related diseases, and 2 million died from exposure to stove smoke inside their own homes. In addition, HIV/AIDS has ravaged the populations of developing nations, killing 3 million people in 2002 alone.

The United States is helping in many ways to combat poverty and deal with these related problems. Under President Bush's leadership the Administration has developed a new economic growth agenda aimed at reducing poverty around the world. The MCA is one part of this agenda. The agenda focuses on channeling more funds to countries that follow pro-growth policies, and on structuring our contributions to create incentives for specific measurable results. These principles are the driving force behind Treasury's reform strategy at the Multilateral Development Banks (MDBs) as this committee is well aware. And I want to underscore the importance that the Administration attaches to the authorization requests related to the MDBs that are pending with this Committee. I look forward to working with this Committee and the Congress, to help make the MDBs strong and effective institutions. These same principles are the driving force behind the MCA. The MCA operates on the principle that aid is more likely to promote economic growth and raise living standards in countries that are pursuing sound

political, economic and social policies. It also seeks to integrate measurement and evaluation into the design of activities to ensure that aid is working.

In a similar vein, I want to emphasize how transparent the Millennium Challenge Corporation (MCC) intends to be. The selection of countries will be based on an objective and transparent assessment of their policy performance on 16 indicators that are key to increasing economic growth. All contracts, activity implementation plans, and measurement and evaluation reports will be posted on the web. The United States is the leading force for increased transparency in the MDBs, and working in collaboration with this committee, we think we have come up with a robust agenda for even greater transparency that we will continue to pursue vigorously.

Treasury will play a vital role in the implementation of the MCA. The Secretary of the Treasury brings to the Board of MCC expertise in policies that promote economic growth and enhance productivity. Furthermore, as the U.S. Governor in the international financial institutions, the Secretary of the Treasury is in a unique position to ensure coordination of MCA programs with the World Bank, the regional development banks and other international financial institutions.

Removing Impediments to Productivity Growth

Sustainable poverty reduction can only be achieved via 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 increase their productivity growth is to increase aid to countries that are taking actions to remove these impediments by following pro-growth policies.

Measuring Pro-Growth Policies

President Bush speaks of three types of pro-growth policies: governing justly, investing in people, and encouraging economic freedom. Note that these three categories correspond to the three types of impediments holding back productivity growth.

To implement President Bush's vision, the Administration chose a set of quantitative indicators of these pro-growth policies. We 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, charitable organizations, universities, think tanks, the private sector, and other interested parties to gather their ideas.

Ultimately, we selected 16 indicators based on their relationship to economic growth, 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, a country will have to be above the median on half of the indicators in each of the three policy areas.

Governing Justly: There are six indicators in this category. The first two are from Freedom House and the latter four are from the World Bank Institute.

1) Civil Liberties: An indicator based on a survey of freedom of expression, association and organizational rights, rule of law and human rights, and personal autonomy and economic rights.

2) Political Rights: An indicator based on a survey of free and fair elections of officials; elected representatives have real power; the right of citizens to form political parties; 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: An aggregate index of existing quantitative indices of governance. One of these indices, for example, measures protection of civil liberties, citizen participation in the selection of governments, and the independence of the media.

4) Government Effectiveness: An aggregate index of such items as the provision of quality public services, competent and independent civil servants, and credible governments.

5) Rule of Law: An aggregate index of 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: An aggregate index that measures corruption among public officials including, for example, bribery, patronage, nepotism, and secret party funding. 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: Our proposal includes two input measures and two output measures.

1) Public expenditure on health as a percent of GDP.

2) Immunization rate for DPT and measles: The World Health Organization publicly compiles and annually releases data on immunization rates for nearly all member countries.

3) Total public expenditure on primary education as a percent of GDP.

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

Encouraging Economic Freedom: There are six indicators in this category covering both macroeconomic and microeconomic policies.

1) Country Credit Rating: Institutional Investor magazine produces a semi-annual survey of bankers' and fund managers' perceptions of a country's risk. A good credit rating reflects good overall economic policy conducive to growth.

2) Inflation: The rate of increase in prices over 1 year. 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: A country's overall budget deficit is averaged over a three-year period.

4) Days to start a business: Compiled by the Private Sector Advisory Service of the World Bank Group, which works with local lawyers and other professionals.

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.

6) Regulatory Quality Rating: The World Bank Institute measures the burden on business arising from, among others, licensing requirements, labor regulations, and bureaucratic corruption.

I should emphasize that none of these indicators is without some problem. There may be gaps or lags in the data, or trends not reflected in the data, which may be material for assessing performance. The MCC Board of Directors will have ultimate responsibility to exercise judgment and look behind the numbers to make a final recommendation to the President on qualifying countries.

Eligible Countries

The MCA aims to reduce poverty and is aimed at poor countries. 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 between $1,435 and $2,975 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.

Measuring Results

The success of any foreign aid program requires that we measure 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 United States made part of its financial commitment to the IDA-13 replenishment in the form of an incentive contribution that calls for 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 sure that every MCA contract states in quantitative terms the expected outcomes. We will require a clear strategy for gathering baseline data and measuring progress toward stated results and assessing the reasons for success and failure. We will require projects to be structured in a way that steps up or cuts back funding contingent on achieving results. Evaluation of results will allow the MCA to incorporate lessons learned into ongoing and future operations. All measurement and evaluation reports, as well as the terms of each contract, will be made public in the United States and in the host country.

In addition to coordinating with USAID, 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.

Conclusion

In summary, the MCA is an operational action plan to use taxpayer resources to help increase economic growth and reduce poverty around the world. I urge your favorable consideration of the "Millennium Challenge Act of 2003."