

WebMemo



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Foreign Aid: Congress Should Shift USAID Funds to the Millennium Challenge Account

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When it comes to spending precious U.S. tax dollars on official development assistance (ODA) to third world countries, the Millennium Challenge Corporation (MCC) has a better approach than the traditional foreign aid model reflected in the mostly ineffective and costly programs of the U.S. Agency for International Development (USAID).

The MCC model demands that recipient governments be held accountable for results and make serious, sustained efforts to combat corruption. MCC programs also encourage private-sector-led economic growth, strong protection of property rights, and the rule of law. Yet in their actions to date, the Obama Administration and Congress have primarily embraced the USAID approach and have made significant cuts to MCC funding.

The Trouble with ODA. The trouble with traditional forms of development assistance as practiced by USAID and other U.S. government entities is that they are generally “top-down,”¹ fragmented,² and do not require “feedback and accountability.”³ Instead, they encourage a welfare-dependency mindset.

ODA promotes a statist and entitlement mentality among recipients and has a poor track record with regard to actually sparking economic renewal. For example, the Organization for Economic Cooperation and Development (OECD) member countries have donated nearly \$3 trillion in foreign aid since 1960, yet these donations have largely failed to produce economic growth.⁴

Notwithstanding ODA's poor track record, proponents of traditional foreign aid are continuously lobbying their powerful political and academic friends in an attempt to make ODA virtually self-perpetuating. The most recent evidence of this pressure can be seen in World Bank President Robert Zoellick's call for “the creation of a ‘vulnerability fund’ for developing countries, a collective pot into which rich countries would put 0.7 percent of their stimulus packages.”⁵

While government assistance programs can be effective in certain situations (such as for humanitarian disaster relief or HIV/AIDS and tuberculosis treatment and prevention), for the most part, private-sector trade and investment is by far the best combination to spur sustainable economic growth—the bedrock of economic freedom in any country.

The MCC: A More Promising Approach to Aid. The MCC has a number of advantages over traditional assistance. MCC programs encourage and allocate aid to countries that embrace policies linked to economic growth and development. The objective indicators used by the MCC to determine which countries will receive fund-

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ing—“based on their performance in governing justly, investing in their citizens, and encouraging economic freedom”⁶—mirror those used by The Heritage Foundation in preparing its *Index of Economic Freedom*. In fact, the MCC uses the *Index* as the source for its trade policy indicator. Specifically, the MCC bases its decisions to allocate aid on a country’s performance on 17 specific indicators contained in Table 1.

MCC programs also place a greater emphasis on transparency and accountability than almost any government program. In order for citizens of a developing country to take ownership and responsibility for their actions, they must have confidence in the system by which they are governed. This sort of buy-in is crucial to the success of any development program.

Recognizing this, the MCC has identified corruption as a critical indicator, noting that “[b]ecause corruption undermines every aspect of sustainable development, MCC has made fighting it one of its highest priorities.”⁷ “MCC asks eligible countries to consult broadly with its citizens throughout the development, implementation, and evaluation of a Compact” and “as part of its own due-diligence procedures, MCC examines the extent to which a country has conducted a consultative process that

reflects real effort to incorporate domestic civic, private-sector, and political institutions.”⁸

One of the founding principles of the MCC is to focus “specifically on promoting sustainable eco-

Millennium Challenge Corporation Selection Indicators

Indicator	Category	Source
Civil Liberties	Ruling Justly	Freedom House
Political Rights	Ruling Justly	Freedom House
Voice and Accountability	Ruling Justly	World Bank Institute
Government Effectiveness	Ruling Justly	World Bank Institute
Rule of Law	Ruling Justly	World Bank Institute
Control of Corruption	Ruling Justly	World Bank Institute
Immunization Rates	Investing in People	World Health Organization
Public Expenditure on Health	Investing in People	World Health Organization
Girls' Primary Education Completion Rate	Investing in People	UNESCO
Public Expenditure on Primary Education	Investing in People	UNESCO and national sources
Business Start Up	Economic Freedom	IFC
Inflation	Economic Freedom	IMF WEO
Trade Policy	Economic Freedom	Heritage Foundation
Regulatory Quality	Economic Freedom	World Bank Institute
Fiscal Policy	Economic Freedom	National sources, cross-checked with IMF WEO
Natural Resource Management	Investing in People	CIESIN/Yale
Land Rights and Access	Economic Freedom	IFAD / IFC

Source: Millennium Challenge Corporation, Selection Indicators, at <http://www.mcc.gov/mcc/selection/indicators/index.shtml> (August 3, 2009).

Table 1 • WM 2574  heritage.org

1. Steven Radelet and William Easterly, “Online Debate: The Effectiveness of Foreign Aid,” Council on Foreign Relations, December 1, 2006, at <http://www.cfr.org/publication/12077/> (June 30, 2009).
2. Steven Radalet, “A Primer on Foreign Aid,” Center for Global Development, July 24, 2006, at <http://www.cgdev.org/content/publications/detail/8846/> (July 23, 2009).
3. William Easterly, “Why Aid Doesn’t Work,” *Cato Unbound*, April 3, 2006, at <http://www.cato-unbound.org/2006/04/03/william-easterly/why-doesnt-aid-work/> (June 30, 2009).
4. See, for example, Raghuram Rajan and Arvind Subramanian, “Aid and Growth: What Does the Cross-Country Evidence Really Show?” National Bureau of Economic Research, August 2005, at <http://www.nber.org/papers/w11513> (June 30, 2009).
5. *The Economist*, “In Need of More,” March 4, 2009, at http://www.economist.com/world/international/displayStory.cfm?story_id=13171686&source=features_box_main (June 30, 2009).
6. Millennium Challenge Corporation, “About MCC,” at <http://www.mcc.gov/about/index.php> (June 30, 2009).
7. *Ibid.*

conomic growth to reduce poverty through investments in areas such as transportation, water and industrial infrastructure, agriculture, education, private sector development, and capacity building.”⁹ A hallmark of underdevelopment is the lack of infrastructure. Building roads, schools, electricity grids, and water systems usually requires the sort of major funding that only government can organize.

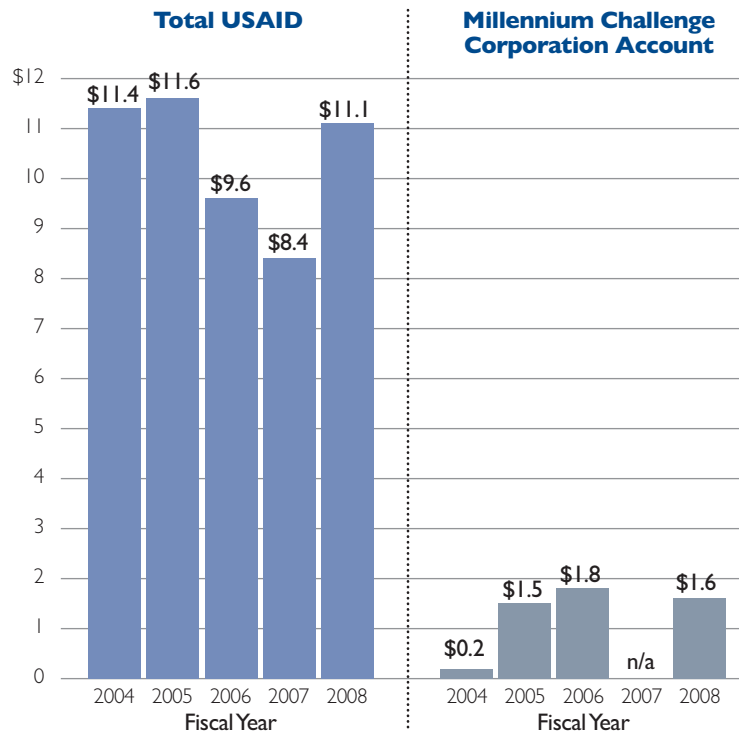
As of November 2008, Congress had appropriated \$7.5 billion to the MCC, of which approximately \$6.5 billion had been obligated for 18 country “compacts.”¹⁰ The MCC funds are designated as “no-year,” meaning that they will not expire and MCC does not have to spend them until it can be certain that the funds will not be wasted. By comparison, during the same period (FY 2004–2008), Congress appropriated \$52 billion to USAID funds that do expire, usually within two years, leading to sometimes rash, reckless, and hurried spending. Sustainable economic growth requires more than a two-year horizon.

The MCC administers \$5.04 million of assistance per employee. This is much more efficient than the average for the U.S. government, which administers only \$1.3 million of assistance per employee.¹¹

Congress: Clueless about Effective Foreign Aid? In the fiscal year (FY) 2009 omnibus spending

USAID Dwarfs Millennium Challenge Corporation

U.S. Foreign Aid, 2004–2008, in Billions



Source: U.S. Agency for International Development “Congressional Budget Justification: Foreign Operations,” FY 2005–2007, Summary Table 1, at http://www.usaid.gov/policy/budget/cbj2005/pdf/fy2005summtabs1_150acct.pdf, http://www.usaid.gov/policy/budget/cbj2006/pdf/fy2006summtabs1_150acct.pdf, and http://www.usaid.gov/policy/budget/cbj2007/summtabs/st_1.pdf (March 11, 2009).

Chart 1 • WM 2574 heritage.org

bill, Congress shortsightedly slashed the funding for the MCC to \$875 million, more than 60 percent less than the \$2.23 billion requested by the Bush Administration for that year.¹² In its FY 2010 budget request, the Obama Administration included a pal-

8. Alicia Phillips Mandaville, “MCC and the Long Term Goal of Deepening Democracy,” Millennium Challenge Corporation, November 2007, p. 11, at <http://www.mcc.gov/documents/mcc-112007-paper-democracy.pdf> (April 29, 2009).

9. *Ibid.*

10. U.S. Senate, “Senate Report 110–425—Department of State, Foreign Operations, and Related Programs Appropriations Bill, 2009,” at http://thomas.loc.gov/cgi-bin/cpquery/?&dbname=cp110&sid=cp110bjg6h&refer=&r_n=sr425.110&item=&sel=TOC_208361& (June 30, 2009); press release, “MCC Compacts Totaling \$2.55 Billion Enter into Force in September,” Millennium Challenge Corporation, September 23, 2008, at <http://www.mcc.gov/press/releases/documents/release-092308-billions.php> (June 30, 2009).

11. William Easterly and Tobias Pfitze, “Where Does the Money Go?” *Journal of Economic Perspectives*, Vol. 22, No. 2 (2008), pp. 29–52.

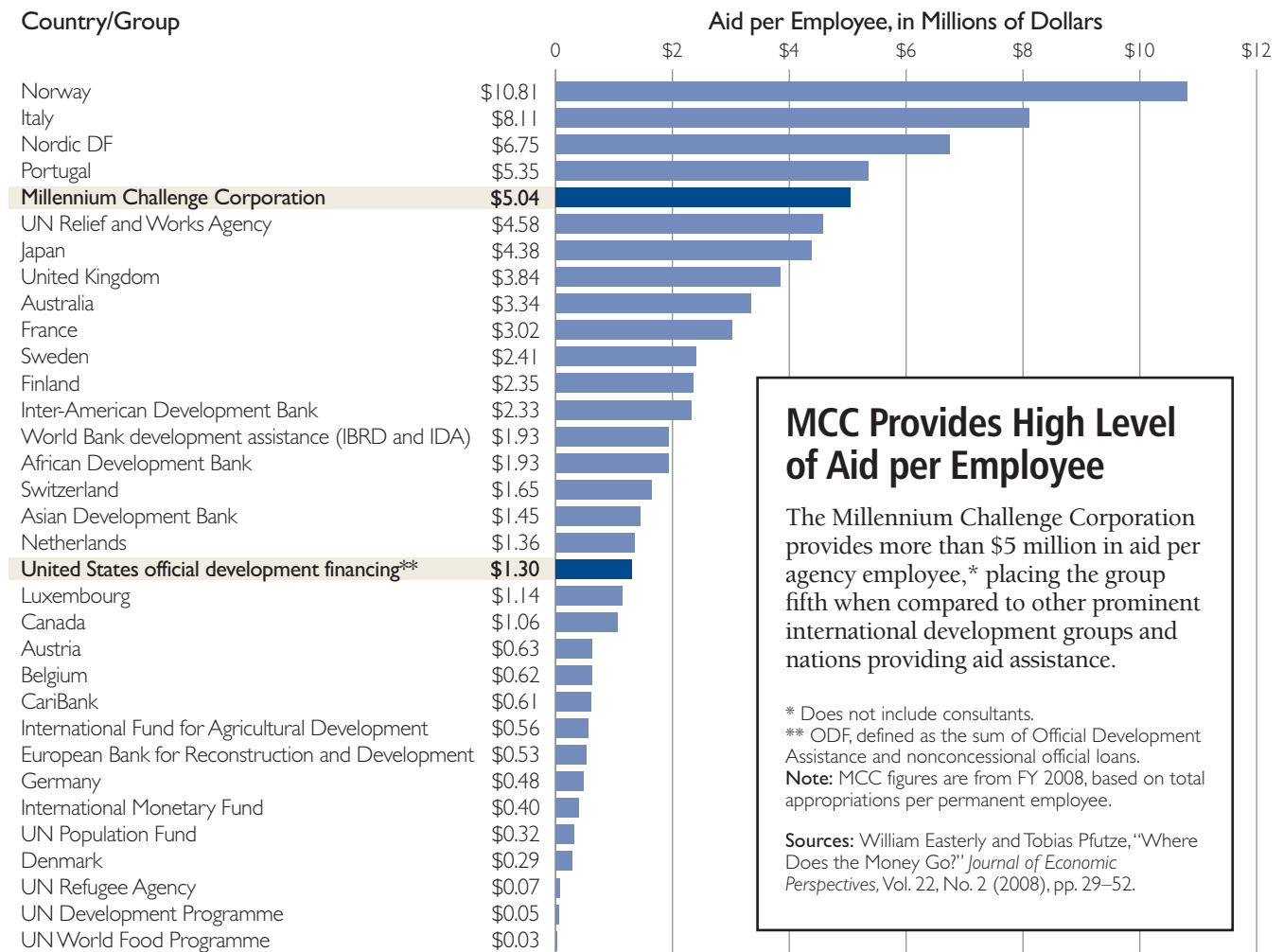


Chart 2 • WM 2574 heritage.org

try \$1.4 billion for the MCC (a cut of more than 40 percent from the FY 2009 Bush Administration request), while it increased the FY 2010 budget for the State Department and USAID by 7 percent—to a staggering \$48.6 billion.¹³ In addition, Congress has already sent worrisome signals in recent FY 2010 budget resolutions that it might cut even the Obama Administration’s modest MCC appropriations.

President Obama says he wants to put “the United States on a path to double foreign assistance,”¹⁴ but, given its lukewarm support of the MCC budget, that means in practical terms that the Obama Administration intends to increase spending massively for traditional ODA programs through USAID and other agencies. These programs will not produce the value-for-money that taxpayers deserve.

12. Committee on Appropriations, U.S. House of Representatives, “Summary: 2009 State and Foreign Operations Appropriations,” February 23, 2009, at <http://appropriations.house.gov/pdf/SFOFY0902-23-09.pdf> (April 6, 2009).
13. Secretary of State Hillary Clinton, “Secretary Clinton’s Testimony on the 2010 Budget Request,” testimony before the Subcommittee on State and Foreign Operations, Committee on Appropriations, U.S. Senate, May 20, 2009, at http://www.cfr.org/publication/19463/secretary_clintons_testimony_on_the_2010_budget_request_may_2009.html (July 1, 2009).
14. U.S. Office of Management and Budget, “A New Era of Responsibility: Renewing America’s Promise,” 2009, p. 88, at http://www.whitehouse.gov/omb/assets/fy2010_new_era/Department_of_State_and_Other_International_Programs1.pdf (July 1, 2009).

Spending Aid More Wisely: What the Administration Should Do. The Obama Administration's development policy should focus primarily on expanding U.S. private trade and investment in and with developing countries. The Administration should press Congress to approve pending U.S. trade agreements with Colombia, Panama, and South Korea. The Administration should also seek to negotiate additional trade deals with friendly, large emerging markets such as India and Brazil.

President Obama and Congress might be tempted to expand, dilute, or revise the MCC criteria. This would be a serious policy mistake. If the MCC criteria were altered to eliminate the existing economic freedom categories, to reduce the currently highest emphasis on rule of law and anti-corruption efforts,¹⁵ or to dilute them by expanding the indicators to include more rigid and unrealistic labor and environmental standards, the resulting MCC programs would no longer be substantively different than the largely ineffective and inefficient traditional ODA programs administered by USAID.

The Obama Administration should take other steps to ensure that any taxpayer funds expended

on ODA are spent as effectively as possible. The Foreign Assistance Act of 1961 should be overhauled to remove structural impediments that constrain the effectiveness of U.S. assistance and prevent it from emulating the more modern aspects of the MCC. Funding for traditional ODA programs administered by USAID should gradually be reduced, and remaining USAID programs should be designed using MCC criteria and policy indicators.

The Administration should work with Congress to restore the more than \$1.3 billion in MCC funding that Congress cut from the FY 2009 omnibus spending bill and increase the FY 2010 budget for MCC to at least \$2.5 billion—by transferring the difference from planned and existing USAID programs.

Moreover, the MCC should adhere closely to its original prioritization of goals, which emphasize encouraging developing countries to adopt and implement policies to fight corruption, strengthen rule of law, and take responsibility for their problems. These criteria should be preserved and remain paramount.

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15. MCC, "Selection Indicators."