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Beyond the Indicators: Delivering Effective Foreign Assistance through the Millennium Challenge Account

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The launch of the Millennium Challenge Account (MCA) holds the promise of being a watershed event in the history of US foreign assistance. The MCA's importance is partly in its scale: the proposed $5 billion annual budget represents a 50% increase over the current $10 billion foreign aid budget, and a near doubling of the subset of that $10 billion that actually focuses on development objectives (rather than security, post-conflict or humanitarian goals).

Perhaps even more important than its size, however, is that the MCA provides the US government with the opportunity to vastly improve the way in which it delivers foreign assistance. US bilateral assistance has been heavily criticized for not having a clear focus or strategy and for not showing sufficiently strong results in recipient countries. Critics see USAID as highly bureaucratic, undermined by competing special interests and extensive earmarking. These problems should not be overstated: it would be wrong to conclude (as some have) that the entire US aid program has been a failure. There have been some great accomplishments, such as USAID's contributions to the Green Revolution, its critical role in developing oral rehydration therapy, its involvement in the successful campaign to reduce river blindness, its groundbreaking work on population and family planning, and its more recent work in supporting innovative microfinace and HIV/AIDS awareness programs. Nevertheless, there is little question that USAID's performance could be improved dramatically. Much aid is wasted on countries whose governments are not serious about development, projects that are poorly designed, and on heavy bureaucracy that ensures that a large proportion of aid money never gets close to its intended recipients. Although many projects are evaluated, too often the lessons learned from those evaluations remain in the file drawers and are not incorporated into subsequent activities. Part of the problem lies with the internal structure and culture of the organization itself; much lies with the elaborate web of legislation and directives from Congress under which the agency labors. To get a sense of the complexity, look no further than the US Foreign Assistance Act of 1961, which, as amended, specifies a remarkable 33 different goals and 75 priority areas.

The MCA is intended to be different. It was proposed as a separate program, rather than an increase in funding for existing programs, so that aid provided through it could be delivered in new and more effective ways. There are two key characteristics of the MCA that distinguish it from current aid programs and provide the foundation for a new approach. First, it has narrower objectives than the overall US foreign assistance program. The overriding objective of the MCA is to help support economic growth and development in the poorest countries in the world. The program is not designed for humanitarian assistance, to help in post-conflict situations (as in Afghanistan), to further security interests (as with Israel and Egypt), or to reward political allies (as with current aid to Pakistan). As worthy as are some of these objectives, they require different approaches than does aid for economic development. The MCA's sharper focus should help improve both the design and evaluation of activities financed by the initiative.

Second, the MCA will provide assistance to only a select group of countries. Under the MCA the USG will provide assistance only to countries that are implementing policies that are consistent with economic growth and development. In his March 15th, 2002 speech, President Bush declared that "(c)ountries that live by these three broad standards – ruling justly, investing in their people, and encouraging economic freedom – will receive more aid from America."[1] The focus on countries that are actively trying to implement sound development policies – the most responsible developing countries -- provides the US with the opportunity to change the way in which it delivers assistance and improve the effectiveness of US foreign aid.

Most of the discussion on the MCA since the President's speech has focused on the "selectivity" issue: how should countries be chosen for eligibility for the MCA? This paper puts that important question aside and addresses a different one: once eligibility is determined, how should aid be delivered to ensure it is as effective as possible in supporting growth and development in recipient countries? It addresses a broad set of issues, including the responsibility for proposing and designing activities funded by the MCA, the types of activities that should be funded, the question of funding projects versus programs, institutional issues within the US government, monitoring and evaluation, and coordination with other donors.

The main recommendations for establishing the MCA can be summarized as follows:
- Allow eligible countries -- by virtue of the fact that they are the strongest performers -- to design their own programs and projects, consistent with their development strategies and coordinated with other donor-funded activities, and propose these to the USG for possible funding;
- Introduce competition among the ideas proposed by eligible countries by funding only the best proposals and by accepting proposals with well-specified goals from governments (national, provincial, municipal), public-private partnerships and non-government agencies;
- Welcome proposals for both projects and broader programs;
- Evaluate the proposals with both country-specific and sector-specific review teams comprised of interagency staff and outside technical experts;
- Keep the number of eligible countries relatively small (at least initially) in order to maintain high standards and focus attention on the quality of projects and programs;
- Reduce funding promptly if recipient country performance starts to deteriorate;
- Establish a new quasi-independent office at USAID to administer the program with separate authorizing legislation, staffed with strong interagency representation on a rotating basis;
- Prohibit earmarking and tied aid;
- Establish strong external monitoring and evaluation mechanisms (including some controlled trials) as part of each project and program in order to ensure financial

[1] The full text of the speech can be downloaded at http://www.whitehouse.gov/news/releases/2002/03/20020314-7.html

accountability and progress towards specified goals, and to learn better about what works and what does not;
- Provide world-class expertise along with the funding so that recipients will want to work with the USG for more than monetary reasons;
- Introduce competition among donors by encouraging other donors to take a similar approach, thus allowing recipients to market their proposals to the most effective aid agency.

Project and Program Proposals

Most US foreign assistance currently is delivered through a country programming approach, in which USAID staff has responsibility for developing an overall country strategy, designing and implementing specific interventions, and evaluating the outcomes. This top-down approach has many shortcomings, including a lack of recipient country ownership in specific projects, only partial (at best) coordination with the recipient country's overall development strategy, a heavy requirement of USAID staff, and little competition between proposed projects. The MCA provides an opportunity to reorganize the way that projects and programs are designed and implemented to better achieve development outcomes, taking clear advantage of the program's focus on only the best-performing developing countries.

Proposal Design

The USG should shift responsibility for designing projects and program from USAID to agencies and organizations within the recipient countries. Proposals for funding should compete against each other, with only the best ones actually receiving funds. In this approach, country eligibility for the MCA will not necessarily guarantee that the country receives funds. Broad eligibility must be coupled with good ideas and a well-thought out strategy for effective implementation. In effect, funding for the MCA would be a two-stage process: (1) the USG determines which countries are broadly eligible for the MCA, and (2) governments or organizations within those countries write specific proposals for MCA funding.[2]

Governments (national, provincial, district, municipal), private agencies (NGOs, research organizations, private schools or hospitals, etc), or public-private partnerships could submit funding proposals. Although some recipient governments might have difficulty with donor funds going to non-government agencies,[3] this option is essential to ensure that funds go to agencies that make the best proposals and can best use the funds. Governments will have to compete against other agencies for funds, some of which are very skilled at implementing effective development projects. In some cases,

[2] Other analysts have made similar proposals for the MCA or for development assistance more broadly, including Nancy Birdsall, et al; George Soros; Bill Easterly; Carol Lancaster, and others. This approach also is broadly similar to the approach taken by the Global Fund to Fight AIDS, Tuberculosis, and Malaria, although it differs in some of the details.
[3] For example, the South African Ministry of Health has objected strenuously to direct funding from the Global Fund to Fight AIDS, Tuberculosis, and Malaria to KwaZulu Natal province, and has threatened to not allow the funds to be delivered unless they go through the Ministry of Health.

governments will wish to work with these organizations in public-private partnerships. Delivering funds directly to non-government agencies would not be a radical new step for the USG, since USAID already provides direct funding to many non-government organizations. Moreover, since MCA-eligible countries are the best performers (including on governance, voice and accountability), presumably governments in these countries will write strong proposals themselves, and will have less difficulty than some other countries might have with funds going directly to non-government agencies. To help ensure that proposals from non-government agencies conform with overall development goals, the review process should put a heavy weight a proposal's consistency with the government's Poverty Reduction Strategy Papers (PRSPs) or other relevant development strategies. Governments in recipient countries should be made aware of proposals from non-government agencies and could be given the opportunity to comment on them, but should not be given veto power.[4] Most importantly, opening the process for competition will foster creativity, innovation, and entrepreneurship, which should lead to higher quality proposals, better projects, and stronger results.

Proposal authors would be expected to clearly articulate the objectives, goals, and timeframes of the program or project, and how progress towards those goals would be measured. These goals and objectives could be drawn from and based on the country's PRSPs or other relevant strategies, or on the international Millennium Development Goals (MDGs). However, the proposals generally should be much more specific that these broad goals. In addition to explicit goals on progress on health, education, and other outcomes, they should include goals for improving administrative and implementation capacity, delivery systems, financial oversight systems, and related capacities. On-going monitoring and ex-post evaluation by external parties would be a central component of each proposal, as discussed in more detail below. Moreover, to ensure strong commitment, recipients generally should be expected to provide some of the funding, with the MCA or other donors providing the majority of funds.

Giving the responsibility for project and program design to recipient countries undoubtedly will increase the burden on organizations in those countries. There is simply no way to increase country ownership of development strategies and participation in the delivery of aid without placing greater demands on staff and other resources in the recipient country. Presumably, that greater investment will lead to more effective projects and programs with better results. In addition, recipients could draw on local or international experts to assist in proposal development and actual project implementation, as appropriate. Thus, current US consulting firms could continue to play a role in both project development and implementation. However, instead of these firms competing against each other in response to USAID's requests for proposals, they would compete to provide their services to the in-country organization that writes the proposal. Ideally, recipients could use MCA funds to pay for the most appropriate expertise available, regardless of the country of origin.

[4] This proposal differs from the Global Fund to Fight AIDS, Tuberculosis, and Malaria in that the latter requires all proposals to first go through a Country Coordinating Mechanism. That process seems overly bureaucratic and creates the potential to stifle new innovative ideas.

Potential recipients might require some assistance in writing high-quality proposals. One possibility would be to set aside a small amount of funds to be used for proposal development in MCA-eligible countries. Potential recipients could write a very short concept paper and submit it to the appropriate technical review panel. If the proposal looked promising, a small amount of money ($5,000 - $25,000 or so) could be provided to allow the writers to hire some technical assistance (local or foreign) and to cover proposal development costs. These funds should be limited so that organizations do not rely too heavily on foreign advisors to write proposals for them.

Proposal Review

Proposals must be vetted by a strong, but streamlined, interagency review process to ensure high standards and outstanding projects. The challenge is to ensure high quality in the proposals through in-depth technical review without making the process overly bureaucratic. To do so, the USG should avoid a large bureaucratic process with layer upon layer of reviews. At the same time, it would be very difficult (and inefficient) to establish one committee with the expertise to vet every project. Staff with expertise on Mozambique should not be vetting proposals from Bolivia, and health experts should not be reviewing microfinance proposals.

I propose a simple, three-stage review process. Each proposal would be reviewed by (1) a country-specific panel, (2) a sector-specific panel (e.g., health or education), and (3) a senior review panel that would make final decisions. Thus, a Ghanaian education project proposal would be reviewed by a Ghana team (to judge the proposal against all other proposals from Ghana), by an education team (to judge it against other education proposals), and then by the senior panel for the final decision. These panels would accept some proposals, require revisions and clarifications on others, and reject others. When the country and sector teams disagree on the funding recommendation, they should meet to discuss the proposal and try to resolve their differences, or send it back to the authors to revise and resubmit. If differences still are not resolved, the proposal should be sent to the senior review panel for final decision.

The panels would have strong staff representation from core agencies (NSC, State, USAID, and Treasury), along with the Departments of Education, Agriculture, HHS, etc, and other agencies where appropriate. For additional independent expertise, these committees should include non-government independent technical experts, who would be full members of the committee with voting privileges, although government representatives would hold the majority. The country-specific teams would include one or more USG representatives resident in the country from the Embassy or USAID, as well as one or more independent national experts (e.g., from local universities). The review panel need not be large -- perhaps five or six members each. Staff with appropriate expertise could sit on multiple panels.

This process would strike a balance between ensuring appropriate technical expertise in the review process and minimizing the requisite administrative apparatus. This system is far less bureaucratic than the current system in which USAID is responsible for developing full country strategies, designing new interventions (which go through multiple in-house reviews), soliciting proposals from private agencies on how they might implement the project, reviewing the proposals, and making funding decisions. Overall, this system would require a far smaller USG bureaucracy to design, review, and implement aid projects. In essence, the proposed new system would signal a change of focus away from project design and implementation towards critical review, monitoring and evaluation (more on the latter two below). It would require some field presence, but probably not as large as is currently the case. It would also bring interagency expertise into the review process, consistent with some other USG international programs.

This "foundation" approach -- with recipient organizations writing proposals for projects they have designed themselves -- would have several advantages over the predominant current USG approach. It would put the responsibility for designing development projects, programs, and strategies where it belongs -- with the recipient country. As a result, this system would guarantee far more country ownership for the development process and for specific projects than is currently the case, and projects and programs would better reflect recipient country priorities. It would create competition among proposals, both within and across MCA-eligible countries, helping to ensure better quality projects. It would help develop greater in-country capacity for designing development programs, while reducing the size of the USG administration needed to oversee the process.

Programs or Projects?

The vast majority of USG foreign aid is used to fund specific projects. Only a limited amount – mainly from the Economic Support Fund (ESF) controlled by the State Department – is directed towards broader programs or for direct transfers to a recipient government's budget. Congress generally strongly favors project loans, since the output is a clearly discernable activity or structure that can be identified distinctly as being funded with USG support. All donors -- the US is no exception -- like to plant a flag with their aid programs. Moreover, advocates of project funding believe that it can be controlled and monitored more effectively than program funding.

However, project funding has many shortcomings. First, the supposed control over spending is largely illusory. Money is fungible, and donor funding for one project simply frees up the recipient's budget and allows money to be used elsewhere for different purposes. For example, donor support to build a school that the government already was planning to build may simply free government funds to buy a new airplane for the president. In this case, the marginal impact of the donor funds is not to build a new school, however carefully monitored the school project may be, but to buy a plane. Second, projects are costly to the recipient, because they are so heavily monitored and require a large commitment of time and money to address all donor concerns. Third, a multitude of projects tends to hollow out, rather than build up, the core administrative capacity of recipient governments. Donor groups hire away the strongest accountants, auditors, and technicians to work on their own projects, leaving behind a much weaker government capacity to administer the government's own projects and programs. Very few donors pay much attention to building capacity in central budget administration, although this is arguably one of the most important institutions in the development process. Fourth, project funding provides much less flexibility for the recipient country than does program funding (by design), which inhibits recipient governments from allocating funds to their highest priorities.

The heavy reliance on project financing contributes to a related issue known as the "recurrent cost" problem. Most project funding is used for capital and other start-up costs, with very little allowed to be used to fund ongoing (or recurrent) project costs. Historically, this resulted from the view that the role of foreign aid was to augment saving and finance investment, not consumption. Donors believe that recurrent expenditures are much harder to monitor and evaluate than capital expenditures, and they are wary about getting involved in long, open-ended commitments that financing recurrent costs might imply. In addition, donors like recipients to contribute some share of the costs in order to strengthen ownership, and the capital/recurrent split provides a convenient rule for cost sharing.

However, there are major problems with donor's reluctance to finance recurrent costs. The distinction between capital and recurrent costs is blurry, and there are high costs to the monitoring involved in trying to keep accounts separate. More seriously, once completed, many development projects are chronically underfunded because recipient countries either cannot or will not devote sufficient funds to keep donor-initiated projects going. Developing countries are littered with donor-funded roads and wells that quickly fell into disrepair for want of adequate maintenance funding. The recurrent cost problem generally is much less of an issue with program funding, since recipients can allocate funds to activities that truly are high priority, and can distribute funds among capital and recurrent costs as appropriate.

One way to reconcile the project-program debate is to recognize that different approaches might be appropriate in different circumstances. More specifically, donors should rely more heavily on program funding in the best performing countries that have shown a commitment to allocate, monitor, and evaluate effectively their development activities and build their budget administrative capacity. Indeed, program aid can actually help build that capacity. In countries with governments that are less effective, project funding might be more appropriate, with a significant share of it allocated through non-government agencies.

Since the MCA-eligible countries, by definition, have a demonstrated track record of setting appropriate budget priorities and delivering effective results, the MCA can and should rely much more on program funding than current US funding. Proposals for program funds should set specific goals, including goals for improving budget and financial capacity, and articulate the activities the funds would help support. This approach would significantly reduce the bureaucratic costs associated with myriad donor-funded projects and would allow governments in MCA-eligible countries to set their own priorities and build their budget capacity. But in return for this flexibility, the USG should maintain strict standards in its program funds: if a recipient government's budget performance begins to falter with poor allocation of funds, mismanagement, or weakening audit and oversight systems, the US should cut its program funds. Recipients also could be required to contribute some funding, without specifying that the donor covers capital costs and the recipient covers recurrent costs.

For example, a government could propose that the MCA help fund its education program, specifying that it would like to build a certain numbers of schools, buy a certain number of textbooks, train some teachers, buy school supplies, establish curriculums and testing procedures, etc. It should also specify goals for strengthening its related budget and financial systems. It would estimate the total cost of the program, set very specific goals, and request that the MCA partially fund the program. It would be unnecessary to draw a distinction between funding for capital and recurrent costs. The important issue would be monitoring and evaluating progress towards the specified goals as the yardstick for continued funding.

Scope of Activities Funded under the MCA

What activities should the MCA fund? One approach would be to allow for the possibility of funding a very broad set of activities across the development spectrum (including health, education, democracy building, co-financing private investments, and a long list of other possibilities) and to not specify a set of activities that the MCA would or would not finance. This approach would be most consistent with the spirit of allowing the recipients to fully choose their own priorities.

However, it would make more sense to restrict MCA funding to a limited set of activities. By trying to fund too many activities through the MCA, the USG could easily spread itself too thin, and not be able to bring to bear the expertise needed to effectively evaluate proposals and monitor and evaluate ongoing activities. The USG is only one of many donors, and in many countries it is not the largest donor. It should resist the notion -- common with many donors -- that just because a particular problem exists, the donor has to fund an activity to try to solve the problem.

One possibility would be for the MCA to finance initiatives in the three areas that the President specified as criteria for eligibility: private sector activities, investments in health and education, and improved governance. This could be a reasonable approach. However, there is no particular reason why the activities funded must match the criteria for selection.

Rather, it makes most sense for the USG to focus its funding on the areas where it has specialized knowledge, expertise, and experience relative to other donors where it can make a tangible difference. In addition, funding should focus on areas where private investment is unlikely, especially high-priority social sectors that have a direct impact on reducing poverty and supporting long-term growth. These guidelines suggest focussing MCA funding on the following six areas:

- Health
- Water

- Education
- Agriculture (including research and rural market infrastructure)
- Microfinance
- Environment

These areas are ones in which USAID has long experience and expertise and has financed many successful projects. They are core to the development process and are high priority investment areas in almost every low-income country. They are consistent with the criteria for the MCA, as well as with most country's PRSPs and the international Millenium Development Goals. And they are areas in which the private sector has underinvested and is likely to continue doing so.

It will be tempting to expand this list to include the particular favorite activities of different individuals and groups, but to do so risks reducing the effectiveness of the MCA and increasing the size of the administrative structure needed to support it. It seems wiser for the USG to focus on a smaller set of activities and do them extremely well than to try to fund too many diverse activities. In particular, the MCA should not be used to finance specific private sector investments such as those undertaken by OPIC and the EXIM bank. Although it is absolutely true that the private sector is the key to long term growth and poverty reduction, it is far from clear that foreign aid is necessary to directly stimulate it. By contrast, foreign assistance can and has played a critical --at times determinant -- role in the areas listed above.

Tied Aid and Earmarks

There have been numerous pledges from the US and other donors to reduce "tied aid," but significant amounts of US aid remains tied. The MCA provides an opportunity for the USG to break from past practices on tied aid that have reduced the effectiveness of US foreign assistance. Congress should resist the temptation to mandate that goods and services can be procured only from the US or the recipient country. The key objective should be for MCA funds to be as effective as possible in supporting innovative development projects and programs using the best expertise available, not to support US firms and organizations that are in the development business. Recipient countries should be free to import needed goods from the lowest cost, most reliable source, and should be able to use the best expertise available to implement their projects, regardless of country of origin. Often, US firms and organizations produce the best products at the lowest price and are the best at what they do, but they will be even better if they are forced to compete with similar organizations around the world. Sometimes, however, US firms are not the cheapest source for goods and services. Mandates that force recipients to purchase US goods when they are not the cheapest alternative may provide some short-term political support for funding, but they are a waste of development dollars, and are one reason for the low rates of return on many development projects in the past.

Similarly, the Administration and Congress should avoid earmarking funds within the MCA for specific purposes other than for the broad areas outlined above. The extent of earmarking within the current foreign aid budget is nothing short of astonishing, and it severely cripples the ability of the USG to effectively allocate funds to the highest priority areas. The Administration should avoid setting aside certain dollar amounts or shares of the MCA budget for, say, health or education, and should let those shares be dictated by the proposal process. Congress, of course, has both the right and the responsibility to direct where appropriated dollars are spent. But too much detail in this directive process is counterproductive. It is impossible to know in advance how much MCA funding should go for specific purposes. Two key principles of the MCA should be (1) to give recipient countries the opportunity and responsibility for establishing their own priorities for aid funding and (2) to hold them accountable for showing the results. There should be no earmarking of funds in the MCA.

Monitoring and Evaluation

Strong monitoring and evaluation is absolutely essential to the MCA's success. Without a much stronger monitoring and evaluation capacity than in past programs, the MCA will be doomed to fail. After the selection process, monitoring and evaluation are probably the most critical aspects of the MCA for its long-term success. A broad thrust of the USG's approach to the MCA should be a re-allocation of administrative effort away from country strategy and project design and towards monitoring and evaluation.

Two separate aspects of monitoring and evaluation are critical: financial accountability and progress towards specified goals. Financial accountability should ensure that funds are spent where they were supposed to be spent, the project remains within budget, regulations on procurement and payment are followed, and that funds are not stolen. USAID has fairly well-developed systems for this kind of monitoring and evaluation, and these practices should continue in the MCA, although they will have to be modified in some ways with recipient countries writing proposals for funding.

Monitoring and evaluation of results requires more discussion. Each proposal under the MCA should set specific goals and targets to meet during the course of the project. Some of these should be intermediate targets (such as building X number of schools, purchasing Y number of textbooks, or reducing the number of days to close the financial books from A to B) and some should be longer-term goals (such as increasing the primary school completion rate from C to D). To monitor progress towards these goals, it is essential that implementers gather relevant baseline data at the outset of every project and program, and that the progress towards the project goals be monitored continuously throughout the project. In other words, monitoring and evaluation must be built into projects and programs from the outset, not added on as an afterthought halfway through the process. Monitoring reports should be reviewed by the same panels that approve projects, and funding should be cut off to projects in which monitoring is not carried out or progress towards targets is not satisfactory. The MCA's success will be heavily dependent on holding recipients to high standards in achieving results, and continuous monitoring and evaluation is the foundation of this effort.

Strong monitoring and evaluation of results play a second role: they help donors and recipients learn what works and what doesn't, which in turn helps future programs and projects to be more effective. Evaluations of every MCA activity should be made publicly available to researchers and analysts, who can help decipher best practices in a wide variety of development activities. The project review panels should be required to read and comment on evaluations of projects that they approved to ensure that lessons learned are reflected in new programs.

How should monitoring and evaluation of results be carried out? One option would be to require each proposal to include expert staff responsible for monitoring and evaluation drawn from outside their organization. The proposal would designate who would perform the monitoring and evaluation, how they would do it, and how the results would be measured. This approach would provide maximum flexibility for the recipient and ensure that monitoring and evaluation were built into the project from the outset. However, having the recipient choose the evaluation team would seriously undermine the credibility of the evaluation process. While internal monitoring and evaluation are important and should be part of each proposal, they are not sufficient on their own to ensure strong results. They need to be complemented by an independent external review.

This function could be carried out by having USAID contract with outside expertise to conduct monitoring and evaluation for a group of similar projects. For this process, USAID could follow something similar to its current Request for Proposals (RFP) process. For example, USAID could issue an RFP for monitoring and evaluation of all HIV/AIDS projects funded under the MCA for a group of (say) five African countries. The organization that wins the bid would then be responsible for monitoring and evaluating all HIV/AIDS projects in these countries. As new HIV/AIDS projects are developed in these countries, proposal authors would be required to work with this team from the outset to build into the proposal appropriate mechanisms for monitoring and evaluation. The funds for this function should not be part of the recipients grant budget, but should come out of a separate MCA sub-account. It is essential that monitoring and evaluation be part of the process from the very conception of the project. If done correctly, this option would ensure independent external monitors and evaluators (that work on behalf of the US government, not the implementers) that are well integrated into the overall project.

Evaluating results is a tricky business. If a health project ends with the village showing a 10% decline in infant mortality after five years, how much of this is due to the project and how much is due to other factors? In many cases evaluators can learn a great deal by examining and comparing trends in adjacent villages, the province, or the nation as a whole. But this is only possible if comparable baseline data is available for these other groups. Under the best of circumstances, these kinds of comparisons yield ambiguous conclusions.

The MCA provides the opportunity for introducing, for at least a small number of projects, a more rigorous evaluation process involving randomized trials with a treatment and control group, as is done with most medical trials and other experiments. A small amount of MCA funds – say 3-5% of project funds – could be designated for projects that incorporate evaluations with control and treatment groups. Project design would include specifying a control group, and systems for monitoring that group in tandem with the treatment group throughout the life of the project. For example, if a group proposes to make available de-worming tablets for school students in a particular village, the proposal would have to include the designation of a control village where de-worming tablets are not provided. Project monitors would track bodyweight, school attendance, school achievement, and a range of other indicators in both villages throughout the life of the project. Introducing control and treatment groups is time consuming and somewhat expensive, and there is no need for this approach to be required in all projects. But it is the surest way to evaluate what works and what doesn't, and the results would be invaluable for designing subsequent projects.

USG Institutional Arrangements/USG Program Administration

Although the MCA will require a smaller administrative structure per dollar spent than current programs, a strong, lean institutional base will be required to ensure the success of the program. There are a variety of options as to where and how the MCA program could be administered within the USG. Broadly speaking, the program could be administered by:

- a brand new agency;
- current offices within an existing agency;
- a interagency commitee;
- a new hybrid office located within an existing agency with strong interagency staffing.

Establishing a new agency would allow the program to function independently of existing bureaucracies, thereby allowing it to get a fresh start unencumbered by previous practices and procedures. However, creating an entire new agency is likely to require a larger administrative structure than is actually necessary to oversee the program. Moreover, practically speaking, there is little chance that the current administration would create a new agency for this purpose. It is already in the midst of creating the new Department of Homeland Security and has created a range of smaller offices (mostly dealing with security issues) and is unlikely to favor additional new agencies.

There are four existing agencies in which the MCA program could be placed: USAID, State, Treasury, and the White House. USAID has the advantage of staff that is deeply familiar with development and foreign aid issues. Furthermore, placement at USAID would help ensure better coordination with existing aid programs. However, USAID is badly encumbered by the multiple goals and objectives of the Foreign Assistance Act and by its many earmarks. While many of its professional staff are among the most knowledge people there are on economic development issues, USAID's structure and bureaucracy have contributed to poor results in current aid programs (although, as noted earlier, there have been some success). Placing the program within the existing structures of USAID would probably condemn it to the same fate.

The MCA could be administered by the Treasury Department, which has the strongest economic and financial analytical skills, and represents the US in the

International Financial Institutions. However, Treasury does not have a large enough staff or sufficient expertise in development issues to administer the MCA. Similarly, the White House (specifically NSC) realistically does not have the staff to run this program. The State Department, by contrast, is large enough to absorb and administer this program, and some people at the Department are likely to push hard to do so. However, while some of its staff have expertise in economics, finance, and development issues (and these staff should play a strong role in the MCA), the overall capability in these areas is probably not sufficient to run the program. More importantly, bringing the MCA into the State Department would assure that political considerations would play a very strong role in allocation and funding decisions, especially over time, which would significantly weaken the program. Because of the potential to politicize funding decisions, the State Department is not the place to either administer or coordinate the MCA.

A third option would be to administer the program with an interagency committee. In this model, staff working on the MCA would be drawn from several relevant agencies, but would actually continue to work for their own agencies. A coordinator from one of the agencies would be designated to oversee the process, with the operational committee reporting to a more senior group of policy makers (at approximately the Undersecretary level) that would act effectively as a board of directors to make major decisions. This option would economize on new administrative structures. It would also have the advantage of bringing to bear diverse interagency expertise and experience.

However, an interagency committee, no matter how structured, would not be able to effectively administer a permanent program of the size of the MCA. The requirements for strong administration are greater than could be handled by this kind of structure. Moreover, the ultimate responsibility for the actions of such an interagency committee would be rather diffuse, even with a Coordinator and a Board of Directors. Who really would be in charge? Moreover, staffing probably would be a problem over time. Members of the committee would either be working part time on the MCA (with some of their attention thus pulled elsewhere), or would be full time but working quite separate from each other. As a result, coordination and efficiency would likely suffer.

A fourth option, and the one that I recommend, would be to house the MCA office at USAID, but to separate it from other USAID offices and to establish it with strong interagency participation. The office would be staffed with a combination of experienced USAID staff, new hires from outside the government (including some from private business) and staff seconded from other USG agencies. Staff from other agencies could include, for example, perhaps five staff members each from Treasury and the Sate Department, and between one and three people each from other relevant agencies such as HHS, NIH, EPA, and the Department of Education. Staff from other agencies should account for a significant share of overall staff (perhaps one-third to one-half), with USAID staffing the balance. These staff would serve on a rotating basis (e.g., for one-two years) and then return to their home agency. This would ensure strong input from several different agencies and would reflect the interagency character of the proposal review committees proposed earlier.

This office should be separate from the other administrative structures of USAID. It would report directly to the Administrator, with the entire operation overseen by a senior interagency board of directors (perhaps at the Deputy Secretary level) that would take all major decisions, similar to Exim Bank's interagency board. The MCA budget, and the operations of this office, should be the subject of authorizing legislation separate from the rest of USAID. In effect, this structure would allow the MCA office to take advantage of existing expertise from around the government but avoid capture by any existing bureaucracy.

The MCA office would serve several functions:

- Act as secretariat to the technical review committees;
- Disburse funding;
- Oversee monitoring and evaluation of ongoing programs and projects;
- Liaise with recipient country representatives, other Executive branch agencies, congressional staff, and NGOs.

This structure would change the size and role of USAID's presence on the ground in recipient countries. Fewer staff would be required, as USAID would neither be designing projects nor involved in detailed daily oversight of project activities. Nevertheless, some staff presence on the ground would be essential to help evaluate the credibility of non-government proposal writers, provide some assistance to potential fundees in drafting proposals, assisting in vetting proposals, and especially in monitoring and evaluation.

This structure would also affect the operations of the consulting firms and NGOs that currently compete for USAID project funding. Currently these organizations devote considerable resources towards their relationship with USAID, trying to understand USAID's priorities, anticipate new project activities, and respond to USAID's proposals in the format and language that USAID expects. In the proposed structure, they would work much more closely with governments and other agencies in recipient countries. If host governments were convinced of the value of their services, they would include these organizations as part of their proposals and ask them to implement key components of the project or program. These organizations could also play a strong role in monitoring and evaluation.

Coordination with Other Donor Activities

How should MCA-funded activities be coordinated with other donor initiatives? The key force to ensure donor coordination is the recipient government. Governments with a clear, sound development strategy and a demonstrated ability to effectively implement development projects -- precisely the requirements for MCA eligibility -- are in a strong position to coordinate donor activities. Uganda is a good example. The government developed its Poverty Eradication Action Plan (PEAP) in the mid-1990s of its own volition several years before the International Financial Institutions began to require PRSPs as part of their funding process. The government chairs regular donor meetings, and it has built up sufficient credibility that donors tend to respond to government requests on the direction of aid. As a result, aid coordination in Uganda --while not perfect -- is less of a problem than it is in many other countries.

By allowing eligible governments to write proposals for funding, MCA activities would be more consistent than current funding with the government's development strategy, and therefore should be easier to coordinate.

MCA projects and programs can easily complement other donor efforts, such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria, or the World Bank's Education for All Initiative. USG funds need not go through these other initiatives to be consistent with and supportive of them (although direct USG funding of the Global Fund with monies separate from the MCA is critical for the Global Fund's success). MCA funds could co-finance activities with these other donor sources in eligible countries, or could finance separate but complementary activities.

Indeed, it is possible that too much coordination between donors may not always be a good thing, as it can give donors too much power in deciding how and where to deliver aid, and provides no pressure on donors to improve their services and reduce their costs. In this spirit, some competition between the MCA and other donors for similar projects and programs could enhance aid effectiveness, as it could help reduce donor's bureaucratic costs and improve the quality of service delivery. For example, a government that would like to fund an AIDS education program would benefit from being able to choose whether to approach the Global Fund, the MCA, or the World Bank for funding. The recipient government could choose the donor with the least onerous administrative process and the most effective technical support. Towards this end, some competition between donors should be welcomed. Of course, donors would have to maintain high standards in the activities they fund, and insist on monitoring and evaluation. It would not be helpful if recipients chose amongst donors based on which one had the lowest standards and expected the least results. Donors should insist on high standards, but competition amongst donors can help reduce bureaucratic costs that make aid ineffective.

Country Eligibility

The process for selecting countries for eligibility for MCA funding is obviously critical. The issues raised by that process -- including the precise indicators to gauge performance, levels versus changes in those indicators, continuous variables versus a “hurdles” approach, the eligibility of middle income versus low income countries, the weighting of different indicators, and recognizing positive and negative turning points in the data in a timely manner for specific countries -- are outside the scope of this paper. Nevertheless, several eligibility issues are germane to the current discussion.

One is the approximate size of the pool of eligible countries. Regardless of the precise method used to choose eligible countries, a key question will be whether to make a large or small number of countries eligible for potential MCA funding. One option is to establish the criteria such that a relatively large number of countries would be eligible for funding (e.g., 40-50 countries). Eligibility would not guarantee funding: agencies within eligible countries would have to submit proposals for funding, with only the best proposals selected. An advantage of this option is that it could create more competition among proposals, since there would be a larger pool of proposals to choose from. Moreover, it would spread the benefits of the MCA to a larger group of needy developing countries. It would also reduce the potential for overly-restrictive eligibility requirements to eliminate worthy countries where aid could be effective. In effect, this option puts less emphasis on the indicators to select countries and more emphasis on the proposal process.

However, there are several problems with this approach. The more countries that are eligible, the less funding will be available for each country, dampening the benefit of eligibility. Moreover, the idea that some countries would be eligible but would not receive funding is simply not plausible. Bureaucratic and political pressures within the US government, especially from staff that work on eligible countries, will inexorably build to ensure that every eligible government receives some funding. The larger the number of eligible countries, the greater these pressures will be. One result will be lower standards for proposals. The benchmark for judging a proposal naturally will become the quality of the weakest proposal previously accepted, and a larger number of eligible countries will increase the pressure to accept weak proposals. In other words, the competitive pressure from more eligible countries could be outweighed by the political pressures to fund weaker proposals, so a larger number of eligible countries could reduce rather than enhance the quality of the program. Related to this point, it is not at all clear that simply spreading funds to more countries necessarily will result in the MCA will have a larger impact on global poverty. There are plenty of worthwhile projects in any of the poorest countries with good policy environments, and it is not clear that reducing the funding in one country and sending it to another just to increase the number of countries receiving funding would do much additional good in the fight against poverty.

In addition, a larger number of eligible countries will require a larger administrative apparatus. A larger number of countries would require more proposal review panels and a larger secretariat to track the relevant information from all eligible countries. Finally, the larger the target number of countries for eligibility, the harder it will become to draw a clear line distinguishing the eligible countries from the ineligible. As a result, it will be very easy for the list of countries to grow. Instead of a program for the best performers, the MCA will become a program for all but the worst. The effectiveness of the programs would likely be weaker. (It is worth noting that if MCA eligibility is limited to IDA-only countries with per capita incomes less than the operational IDA cutoff of $875, only 66 countries would be possible candidates for the MCA.[5] Establishing eligibility requirements so that 40-50 of these would ultimately be eligible implies fairly weak requirements.)

[5] Officially, 80 countries are listed by the World Bank as IDA-eligible. Four countries are inactive (Liberia, Sudan, Somalia, and Myanmar). Ten others qualify under the "small island economy exception," all of which have per capital incomes greater than $1000. This leaves 66 active, eligible countries with per capita incomes less than $875.

The alternative is to set higher standards for country eligibility, limiting the MCA to a smaller number of countries (e.g., 15-20), at least initially. Once again, country eligibility would not guarantee funding, as agencies within eligible countries would be required to submit specific proposals for funding. One advantage to this approach is that more funding would be available for eligible countries, increasing the incentive to meet the eligibility requirements. Moreover, with fewer eligible countries, there will be less political pressure to accept weaker proposals (although it will still exist). As a result, the impacts of the MCA should be more evident, which should lead to continued support for the program over time. Moreover, a smaller staff could administer the program.

This approach also has its problems. It puts a very heavy weight on the indicators used to distinguish eligible from ineligible countries. Given the weaknesses and time lags inherent in the underlying data, the process ultimately may become more subjective and imprecise than it appears on the surface. Moreover, this approach runs the risk of excluding some very good projects and programs in countries that do not quite meet the eligibility standards. Finally, putting a large amount of funding into a small number of countries could lead to diminishing returns on the projects, as implementers run into capacity constraints and face difficulties in absorbing new funds (the potential size of this problem is diminished somewhat by funding non-government agencies).

Despite these drawbacks, a smaller number of eligible countries seems the better approach, at least at the outset of the MCA. Over the long run, the most important issue is to ensure that the MCA shows strong results and proves that aid can be effective if delivered in innovative ways in the right circumstances. If the program can show clear results in its early years, support for the MCA will grow, and it can spread over time to additional countries. If, on the other hand, the MCA becomes unwieldy and its standards decay, it could easily become just one more failed aid program, with little support for continued funding. In my judgment, the greatest threat comes from the potential for political and bureaucratic pressures to weaken the quality of projects and programs if too many countries become eligible too quickly. This suggests starting with a smaller number of countries and a tighter administrative bureaucracy, focussing on quality, making sure the program works well, and then expanding the number of eligible countries over time.

Absorptive Capacity

The number of eligible countries will determine, to a large extent, the amount of money received per country. $5 billion per year is a large amount of money to be spread among 15-20 countries, implying an average increment of $250 - $333 million per year in each recipient country. The 66 active IDA eligible countries with per capita incomes less than $875 received capital flows averaging $384 million in 2000, equivalent to about 12% of GNP or $44 per capita. Can these countries effectively absorb such a large increment of new aid?

This is a critical question, and it cannot be answered with certainty in advance. It depends critically on the particular needs in each country, the activities that aid finances, how well the MCA aid is coordinated with other programs, the strength of government institutions through which most of the aid will be channeled, and the strength and depth of the non-government agencies that may receive some aid. Some countries have absorbed relatively large amounts of aid over extended periods. In Botswana, for example, aid flows averaged 14% of GNP during the late 1970s, and averaged $110 per person in the 1980s.

The differences in aid flows in the 66 IDA-eligible countries reflect these differing circumstances, and suggest that hard and fast rules on limiting the size of aid flows in each country would be difficult. Aid flows in these countries in 2000 ranged from $18 million (Comoros) to $1.7 billion (Vietnam and Indonesia); from less than 1% of GNP (India and Nigeria) to 75% of GNP (Sao Tome and Principe); and from less than $2 per capita (Nigeria and India) to $236 per capita (Sao Tome and Principe). Of course, in some countries this aid was used effectively, in other countries much was wasted. Larger numbers, however, do not necessarily imply wasted aid. Mozambique received aid equivalent to 23% of GNP in 2000, or about $50 per capita. Whether or not it can effectively absorb more is a good question, but given Mozambique's recent strong performance, it indicates that it has put a large amount of aid to good use.

Absorptive capacity problems manifest themselves through higher costs and weaker results for new projects and programs. The keys to monitoring these effects are built into the proposed MCA process: critical review of proposals with clear goals and objectives, and ongoing monitoring and evaluation of progress towards those goals. Strong mechanisms for monitoring and evaluation, along with the willingness to reduce and/or redirect aid flows when goals are not met, are the right tools to address the absorptive capacity issues.

Implications for Non-Eligible Countries and Existing Aid Programs

Of course, limiting the number of eligible countries does not mean that the USG will abandon countries that are ineligible for the MCA. As the President announced it, the MCA would be based on new funding, so the existing $10 billion in foreign assistance will remain in place. While Congress and the administration finalize the details of the MCA, it is critical that MCA funding indeed be in addition to existing funds, rather than taken from them. This will allow US assistance to continue in various forms --some similar to and some different from the MCA -- in a large number of countries.

One important group of countries are those that are close to the MCA eligibility standards, but don't quite make it. USAID should work with those countries to design specific projects and programs to help strengthen their performance in the areas in which they were judged to be weak. For example, in a country whose educational policies are not up to the MCA standard, the US could assist in strengthening educational policies and programs. Funding for these programs should come from existing monies, NOT from the MCA. For the reasons stated above, it is important to maintain high standards for MCA eligibility, and to retain all MCA funding for worthwhile projects and programs in eligible countries. Other funds can be used to help countries that initially are ineligible.

Existing programs should also continue in countries that are further from the standards for MCA eligibility. In many cases, the immediate objectives differ from the MCA: aid is designed to help in post-conflict situations, assist a new government in the immediate aftermath of a fall of a dictator, or to provide humanitarian assistance. In addition, some aid will continue in middle income countries that do not qualify for the MCA because of the income threshold. Since the objectives and circumstances differ in these countries from the MCA countries, the design and delivery of aid should differ as well. Some aspects of the MCA program -- such as giving recipient countries more responsibility for project design -- may be applicable in other countries as well. Especially in countries with poorly performing governments, USAID should continue to explore ways to deliver assistance effectively, perhaps with more funds going through non-government agencies[6]. The precise details of how these other programs should be reformulated is beyond the scope of this paper. The establishment of the MCA should provide the opportunity to think out of the box and consider innovative ways to deliver aid in these other circumstances.

[6] Although recent experience in Haiti illustrates that working around the government is not necessarily a panecea.