US Development Aid and the Millennium Challenge Account: Emerging Trends in Appropriations

October 2006

Kaysie Brown, Bilal Siddiqi and Myra Sessions*

"Today, I call for a new compact for global development, defined by new accountability for both rich and poor nations alike. Greater contributions from developed nations must be linked to greater responsibility from developing nations. The U.S. will lead by example. We will increase our development aid by 5 billion dollars over the next 3 budget cycles. This new money…is ***above and beyond*** *existing aid requests in the current budget, submitted to Congress. The funds will go into a new Millennium Challenge Account."*

-- President George W. Bush, Monterrey, Mexico, 2002

Summary

The MCA budget request constituted the single greatest line item increase in the foreign operations budget in FY 2007, while certain core development accounts have declined. Some have voiced concern that despite President Bush's promise, increases in MCA funding are diverting money away from USAID. This paper analyzes the extent to which increases in MCA funding are coming at the expense of existing development programs.

Our analysis of USAID budgetary requests and appropriations over FY 2002-2007 show that global aid is stagnant in the "post-MCA" period (FY 2005-06), with no real signs of it increasing in FY 2007. We also find that, on average, 'core' development financing has dropped for MCA eligible and compact countries since FY 2004, particularly in Africa and Latin America. Indeed, only two compact countries—Vanuatu and Cape Verde—are able to claim full additionality of MCA funds. Yet, and contrary to expectations, US development aid appropriations to MCA countries have on average fared better than non-MCA countries. Given these findings, we hesitate to draw any strong conclusions about the degree to which the MCA is responsible for cuts in other development aid.

That said, our analysis includes two important conclusions:

- MCA eligible and compact countries have experienced unequivocal reductions in the Development Assistance (DA) account of US development aid;

* Kaysie Brown (kbrown@cgdev.org) is a Program Associate at the Center for Global Development. Bilal Siddiqi was a research assistant and Myra Sessions a program coordinator at CGD until summer of 2006; they are both currently pursuing graduate degrees.

- Greater transparency and accessibility of data on US foreign aid, in the form of a centralized and comprehensive database, is an essential predicate to creating more effective decision making and oversight by the U.S. government and key aid constituencies.

Introduction

In March of 2002, President Bush unveiled his flagship development program, the Millennium Challenge Account (MCA). Built on the premise that a portion of US development aid should be given to countries that have a demonstrated commitment to good governance in three general categories—ruling justly, investing in people, and promoting economic freedom—aid under the MCA was not to come at the expense of existing funding for development programs.[1] Accordingly, the President claimed that funding for the MCA would be "above and beyond"[2] aid requests, which were expected to increase to $5 billion by FY 2007.

Since the Millennium Challenge Corporation (MCC)—the entity charged with administering the MCA—has become operational, the original vision of $5 billion in aid increases for MCA eligible countries has not come to fruition. For FY 2007, the president requested $3 billion and Congress appropriated only $2 billion to the MCC, the highest allocation yet, but still far below the original vision. The new aim is to ramp up aid requests to the $5 billion target by FY 2008.

Despite being below original forecasts, the MCA budget request constituted the single greatest line item increase in the foreign operations budget in FY 2007. At the same time, requests for certain core development accounts seem to have declined.[3] Aid practitioners, advocacy groups and policy analysts have voiced concerns that despite President Bush's promise, increases in MCA funding are coming at the expense of existing development programs and are diverting money away from the United States' main aid agency, USAID.

This paper tests the above hypotheses. If MCA money really is being appropriated at the expense of other accounts, we would expect global aid to stagnate in the years following the creation of the MCA, especially in the "core" accounts that are used to fund development-related activities, which for the purposes of this paper we have defined as those activities funded through the accounts of child survival and health (CSH), development assistance (DA), economic support funds (ESF), and support for East European and Former Soviet Republic democracy programs (SEED and FSA). Furthermore, as some well-performing countries get the nod from the MCA, we would expect other sources of funding to start to dry up or be redirected elsewhere, so that over time MCA eligible

---

[1]For FY 2006, MCC eligible countries were identified as those that: have a per capita income level of less than $3,255; rank above the median score on half of the indicators in each of the three categories of ruling justly, economic freedom and investing in people, as well as pass a hard hurdle for democracy; and are agreed upon by the MCC Board. MCC Compact countries are those who have been invited by the MCC Board and have submitted a successful proposal for funding.

[2] While there is no definitive definition of what additionality means, in this paper we argue that, in order for initial promises of 'above and beyond' to be meaningful, funding has to be: above and beyond the prevalent trend in *global development aid*; above and beyond *at the country level* for countries eligible to apply for MCA support, and; above and beyond existing accounts that share the MCA's key objectives of *economic growth and poverty reduction.*

[3] See: Interaction, "FY 07 Budget Request Cuts Core Programs to Fund Initiatives," at http://www.interaction.org/campaign/leg_FY07_budgetcuts.html, and US Global Leadership Campaign, "Congressional Briefing: FY07 International Affairs Budget Request," February 23, 2006, at http://www.interaction.org/files.cgi/4818_GLC_150_Budget_Summary_.ppt#256,1 ,U.S. Global Leadership Campaign.

countries would tend to get relatively less money from traditional aid accounts compared to "non-MCA" countries. In this scenario, accounts most directly related to the kinds of development programs that the MCA supports would feel the greatest pinch.

Development Aid Composition

Despite a growing body of literature on US foreign aid spending, there is not a universal or widely accepted definition of what exactly constitutes development aid. Some have opted to include the full spectrum of aid to developing countries, including aid for humanitarian purposes, while others have defined development aid more narrowly.[4] This diversity of definitions results both from the wide variety of accounts, sectors and strategic objectives within foreign aid programs, as well as the inherent difficulties in assembling complete data for all countries and accounts: currently, nearly 50 U.S. government agencies provide some type of foreign aid through approximately 20 different funding streams.

For the purposes of this study, we focus on USAID programs that appear to contribute most directly to the MCA's core objectives of "economic growth" and "poverty reduction".[5] Thus, the definition of *core development aid* as is used in this paper includes:

- Child Survival and Health (CSH)[6]
- Development Assistance (DA)
- Economic Support Fund (ESF)
- Support for East European Democracy (SEED) and FREEDOM Support Act (FSA), where applicable

Development Aid Trends

According to the OECD Development Assistance Committee, US Official Development Assistance to the developing world has increased dramatically in the past several years, from $11.4 billion in 2001 to a staggering $27.5 billion in 2005.[7] Unsurprisingly, Iraq accounts for much of the increase, receiving $10.2 billion in 2005, as does Afghanistan, which received $1.5 billion in the same year. Most of the rest of the increased funding is being allocated to the Global HIV/AIDS Initiative (GHAI), as well as to the MCA.

---

[4] See for example: Nancy Birdsall, Isaac Shapiro and Brian Deese, "How Significant are the Administration's Proposed Increases in Foreign Development Aid?", Center for Global Development/Center on Budget and Policy Priorities, May 20, 2003; Rikhil Bhavnani, Nancy Birdsall and Isaac Shapiro, "Whither Development Aid? An Analysis of the President's 2005 Budget Request", Center for Global Development/Center on Budget and Policy Priorities, July 2004; Susan E. Rice, "U.S. Foreign Aid to Africa: Claims vs. Reality", The Brookings Institution, June 2005; Steve Radelet and Bilal Siddiqi, "U.S. Pledges of Aid to Africa: Let's Do the Numbers", Center for Global Development, July 2005; Todd Moss, David Roodman and Scott Standley, "The Global War on Terror and U.S. Development Aid", July 2005.

[5] While we collected information for total development aid provided by USAID, including for example food aid (PL 480, Title II), migration and refugee aid (MRA), international military education and training (IMET), and the Global HIV/AIDS Initiative (GHAI), used to support programs to combat HIV/AIDS in the fifteen focus countries under the President's Emergency Plan for AIDS Relief (PEPFAR), our study focuses upon changes in what we call "core" development aid. Our main conclusions, however, were not sensitive to the precise definition of aid.

[6] Also called CSD in fiscal year 2002.

[7] See http://www.cgdev.org/doc/blog/USODA2001-05.pdf

Meanwhile, we have seen visible declines in the appropriations for bilateral core development aid over this time period, from $7.5 billion in FY 2002 to an estimated $6.6 billion in FY 2006. This includes a visible global downward trend of core development aid since FY 2005, the year after the MCA was launched. So, while funding appropriated to the MCA seems to be additional relative to other development aid on a global level, core development funding has actually declined, overall and for MCA eligible countries, since the MCA came into effect in FY 2004. This casts doubt on the claim that appropriations for MCA eligible countries for core development aid—assistance aimed specifically at poverty reduction and economic growth—is above and beyond what they had received prior to the existence of the MCA.

❖ *Regional Trends*

At the regional level, some major funding shifts for core development aid have taken place since FY 2004 for MCA eligible countries. Only MCA eligible countries of South and Central Asia and the Near East have seen increases in core development aid, with the Near East receiving a 200% increase since FY 2004. Other regions have not fared so well; in Africa's twelve MCA eligible countries, average core development aid appropriations over FY 2005-06 (the "post-MCA" period) were actually 10% lower than aid appropriated over FY 2002-04.[8] This does not include GHAI funding, which was intended—along with the MCA—to be supplemental to core development funding. If you include funding for the HIV/AIDS program, you see that appropriated funding for MCA eligible countries in Africa has increased by 65% since FY02, which is not to be taken lightly. In comparison, however, MCA eligible countries have only seen increased levels of aid roughly ½ that of non-MCA eligible countries in Africa (which has seen a 126% increase in funding for core development aid plus GHAI funding).

Similarly MCA eligible countries of the Western Hemisphere (Latin America) saw a steady decline in core aid appropriations in the post-MCA period, from $34 million in FY 2004 to $31 million in FY 2006. Similar trends have emerged for eligible countries throughout East Asia and the Pacific, Europe and Eurasia.

❖ *Country Level Trends*

On a country level, most of the MCA eligible countries have received unequivocal reductions in core development aid since FY 2004. In fact, of the current 23 eligible countries, the only increases in core development aid have occurred in Ghana, Madagascar, Morocco and Senegal. Likewise, the there has been an unambiguous decrease across the board in appropriated aid in all but two of the seven compact countries that receive core development funding—and simply because Cape Verde and Vanuatu do not receive specific country funding.

Table 1: US Development Aid Appropriations: FY 02-FY 06 (excluding the Big 6)

	FY02	FY03	FY04	FY05	FY06	Average FY02-04	Average FY05-06	± %	Change FY02-04	Change FY04-06
Core (CSH, DA, ESF, FSA/SEED)										
MCA	27.5	27.0	24.6	25.1	23.1	26.4	24.1	-9%	-11%	-6%
Non-MCA*	23.7	29.3	19.9	19.7	16.9	24.3	18.3	-25%	-16%	-15%
Extended (Core + MRA, PL480, Peace Corps)										
MCA	34.3	36.1	32.7	32.7	30.3	34.4	31.5	-8%	-5%	-7%
Non-MCA*	29.4	41.1	30.5	28.2	20.0	33.7	24.1	-28%	4%	-34%
Development Assistance (DA)										
MCA	9.2	9.8	9.3	8.5	8.1	9.4	8.3	-12%	1%	-13%
Non-MCA*	3.6	4.0	3.9	4.0	3.9	3.9	4.0	2%	9%	-2%

❖ *Compared to non-MCA eligible countries*

Contrary to our expectations, however, while development aid to MCA eligible countries has shrunk in recent years, so too has assistance to non-MCA eligibles. In fact, MCA countries on average fared better than non-MCA countries. Table 1 highlights that, whereas MCA countries experienced an average of a 9% reduction in funding over the last several years, non-MCA countries saw reductions in appropriated funding for core aid on the order of 25%. This figure does not include the very largest recipient of aid—Iraq, Afghanistan, Israel, Egypt, Jordan and Pakistan—who represent outliers in terms of their massive aid levels. If they had been included in the figures, they would have skewed the data for average funding going to developing countries.

This trend remains even if we were to extend beyond the more limited definition of core development aid to include programs such as food aid, migration and refugee aid, and funding for Peace Corps, for example.Thus, claims of biases against MCA eligible countries have not come to fruition. Given these findings, we hesitate to draw any strong conclusions. That aggregate foreign aid is stagnant does not necessarily imply that the MCA is cutting into traditional financing, since core development accounts have had to compete with such extraordinary budgetary demands as rising war costs, the aftermath of Hurricane Katrina, and an ever-increasing budget deficit. That MCA countries seem to be doing better than non-MCA countries may simply suggest that US development aid is being given preferentially to "good" performers. And the clearer declines in certain aspects of development funding (including aid directed at vulnerable children, family planning and higher education programs) across the board for all countries may be at least partly explained by the increased reliance on funding allocated to 'strategic' regions of importance—such as the Middle East and Central Asia—through the increased use of Economic Support Funds.

MCA as the New Economic Growth Arm of US Foreign Aid?

One central finding is, however, significant: MCA eligible and compact countries have been allocated less money through the development assistance (DA) account since the establishment of the MCA. Since MCA compacts and proposals have tended to target sectors that were traditionally funded through the economic growth, agriculture and trade (EGAT) component of the DA account—indeed, seven of the nine compacts to date focus on agriculture and rural development and infrastructure—this reduction in funding may be part of a broader strategy to move funds away from those sectoral areas where MCA compacts and proposals primarily concentrate. Interestingly, Table 1 shows that while MCA eligible countries received fewer reductions in US development aid than its non MCA eligible counterparts, cuts in the DA account have been much more noticeable for MCA eligibles. Whereas non-MCA countries have received stagnant appropriated funds for the DA account, MCA countries have seen a marked decrease in DA funds, with FY 04 being the apex of DA funding followed by significant decreases in appropriations in FY05 and FY 06 within the DA account. As Annex 1 illustrates, the focus of all nine MCA compacts thus far has primarily been on private sector development and economic growth. In seven of the nine compact countries that have USAID country offices, recent USAID sector cuts through DA funding have been consistent with the focus of the MCA compact. This means, in effect, that USAID funding has been cut in sectoral areas that have traditionally been funded through EGAT projects at USAID.

The FY07 request appears to further solidify this movement to decrease USAID DA programs in MCA eligible countries. For example, in Madagascar, the $110 million MCA compact aims to raise agricultural incomes by protecting property rights, expanding credit, and employing advanced farming techniques. Requests for USAID projects under EGAT dipped to $7.7 million from last year's appropriations of $9 million. This would essentially decrease USAID spending for private sector initiatives to 40% of the Agency's budget, compared to nearly 50% a year ago.

In Honduras, the MCA's $215 million compact also focuses on private sector activity, aiming to reduce poverty by increasing agricultural productivity and lowering transportation costs between national, regional, and global markets. USAID's EGAT appropriated spending levels in 2006 for Honduras was approximately $17 million, and this year's request is not quite $11 million, accounting for a potential 65% reduction in this sector. Nicaragua's $175 million MCA compact aims to spur economic growth by strengthening property rights, reducing transportation costs, and increasing farm wages. Its USAID activities funded under EGAT have likewise dropped, from nearly $14 million last year to almost $9 million this year. Armenia's USAID economic growth program has also fallen significantly this year from last year's estimated spending—from $38 million to $22 million. The trend also occurs in Georgia, where USAID's EGAT funds have decreased significantly, from $42 million last year to this year's request of $23 million.

Strikingly, for the FY 2007 budget request, Benin has experienced a nearly 100% reduction in EGAT funding from last year, with the country's education component being severely downsized, from $6 million to just $400,000. While difficult to lay blame on MCA resources for this extreme reduction since the MCA-Benin compact has no education component, EGAT funding has nevertheless slipped considerably in Benin from past years. Finally, the newest compact recipient, Ghana looks to receive a reduction in DA assistance from an estimated $25 million spending in FY 2006 to a request of $15 million for FY 2007.[9]

There could be a lot of different reasons for cuts in core funding to these countries. There might be a (warranted) belief that cuts in these sectors will be supplemented by MCA assistance. Alternatively, reductions might be a result of changes to or phasing out of existing USAID country multi-year plans. Whatever the exact reason, the data shows quite clearly that cuts in USAID appropriated funding to MCA countries are taking place primarily within the DA account. Yet, the fact that the

[9] By comparing estimated FY06 spending for eligible countries to FY07 requests, it appears that there have also been unequivocal reductions in EGAT requests for: East Timor, El Salvador, Ghana, Namibia and Senegal.

data and budget presentation do not allow analysts to fully understand the reasons is an important finding in and of itself.

Where to Go From Here?

Overall, MCA eligible and compact countries have in fact received reductions in core development aid accounts since FY 2004. Surprisingly, however, such reductions take place on a global level, regardless of a country's MCA eligibility status. The trend appears to be further solidified in the FY 2007 budget request. For the first time in several years, the President's request shows cuts across the board in core development aid programs such as economic growth, vulnerable children, family planning and higher education. Amid significant belt-tightening due to the cost of financing the US's continued engagement in Iraq and Afghanistan, Katrina, and supporting various efforts aimed at strengthening the global war on terror, blame does not lay squarely on the MCA for reductions in core development aid.

The overriding finding from this study reveals that reductions in USAID appropriations for MCA eligible and compact countries is most notable within the DA account, which have occurred consistently since FY 2004. Initial analysis indicates that cuts in the DA account come in the same sectors now receiving funding through MCA grants. Hence, within DA, funding reductions are primarily concentrated in the EGAT accounts.

In future years of budget allocation, it will be important to keep an eye on the relationship between MCA funding and USAID allocations. While MCA compacts represent significantly larger funding totals than current USAID funding packages, it is important that other programs funded under EGAT but not necessarily included in a MCA compact are not being cut arbitrarily. One could take Benin as an example, where, as mentioned above, USAID's education program has been significantly downsized relative to its stated country plan, yet the MCA compact has no education component. Additionally, it would be shortsighted of budget-makers to necessarily assume that a country is going to receive compact funding simply because it is MCA eligible. As stated by the MCA itself, the process by which eligible countries are successful in having a compact proposal approved is an iterative one; being eligible gives select countries the opportunity to submit a compact proposal based on national development priorities. It may be shortsighted for USAID to think either that an eligible country will absolutely receive compact funding or that compacts will continue to focus on economic growth and private sector development (although past practice highlights this trend). These assumptions may in fact do more harm than good, disrupting existent USAID country plans and making funding even more volatile.[10]

While strategic collaboration is critical to effective aid, the MCA and USAID should be careful not to pigeonhole themselves, with the MCA becoming USAID's economic growth arm of the US development aid architecture, and USAID concentrating on health and other programs perhaps not directly focused on economic growth or private sector development; Conversely, if that is the intent, then USAID should be more transparent about its decisions. With the creation of the Director of Foreign Assistance (mandated to oversee a reorganization of US foreign aid, which includes

[10] This may have ramifications for the MCA and country performance, as part of the appeal of the MCA by recipient countries—what has been termed the MCA Incentive Effect—has been that it will be rewarded with additional money, not punished through reductions in other, essential services.

providing coordination and guidance to the MCC), the time is now ripe for the MCA, USAID and the State Department to initiate serious conversations about how best they can work with one another—and not at cross purposes—to generate economic growth and reduce poverty in developing countries.

Finally, our research on this topic confirmed just how difficult it is to find government-wide funding appropriations on a country basis, let alone broken down by sectoral issues. While we accumulated information on USAID appropriations on a sector by sector basis, we were only able to do so by scouring the US Congressional Budget Justifications for the past several years, by country and by general programmatic areas. There is currently no one place to house this information in an easy to read, digestible way. This incredibly tedious approach actually acts as a disincentive for policymakers in creating greater coordination and complementarity of foreign aid efforts. At the very least, the Director of Foreign Assistance should spearhead the creation of a system that would document US foreign aid—by country, by programmatic area, by objective, and by results achieved—into a single database, thereby alerting different agencies to duplication of efforts, as well as key gaps in funding.

Notes

The authors would like to thank Larry Nowels, formerly of Congressional Research Service, for his insights into deciphering the beast of the U.S. foreign aid budget. They would also like to thank the following individuals for their constructive advice on this paper: Steve Radelet, Sheila Herrling, Sarah Rose, Stewart Patrick and Sarah Jane Hise.

Annex 1: Millennium Challenge Compacts Signed and Approved to Date (as of August 2006)

Country	Total compact ($ millions)	Number of years	Compact money per year ($m)	Change in core request over FY06-07 ($m)		Change in DA request over FY06-07 ($m)		Compact Focus by Sector
Armenia	236	5	47.2	-5.0	-9%	na	na	Rural road rehabilitation, agricultural projects, irrigation infrastructure, technical and financial assistance to support farmers and agribusiness
Benin	307	5	61.4	-5.5	-39%	-6.7	-94%	Port rehabilitation, access to land, financial services, access to justice
Cape Verde	110	5	22.0	na	na	na	na	Water management, build infrastructure, agricultural support, private sector development
Georgia	295	5	59.0	-9.0	-13%	na	na	Rehabilitate regional infrastructure outside the capital, promote private sector development
Ghana	547	5	109.4	+4.5	+15%	+4.0	+34%	Agriculture support, transportation infrastructure and rural development
Honduras	215	5	43.0	-5.3	-17%	-6.6	-33%	Increase agricultural productivity, improve transportation links between producers and markets
Madagascar	110	4	27.5	-0.8	-4%	-2.3	-22%	Secure formal property rights to land, access credit and protect savings, train in farming techniques
Nicaragua	175	5	35.0	-6.5	-22%	-8.3	-39%	Strengthen property rights, improve access to markets for rural communities, increase wages and profits from farming in select regions
Vanuatu	66	5	13.2	na	na	na	na	Improve poor infrastructure and strengthen public works departments

Annex 2: MCA Compact and Eligible Countries

MCA Compact Countries as of August 2006

1 Armenia
2 Benin
3 Cape Verde
4 Georgia
5 Honduras
6 Madagascar
7 Nicaragua
8 Vanuatu
9 Ghana

MCA Eligible Countries: FY 04-FY 06

2004 Eligible

1 Armenia
2 Benin
3 Bolivia
4 Cape Verde
5 Georgia
6 Ghana
7 Honduras
8 Lesotho
9 Madagascar
10 Mali
11 Mongolia
12 Mozambique
13 Nicaragua
14 Senegal
15 Sri Lanka
16 Vanuatu

2005 Eligible

1 Armenia
2 Benin
3 Bolivia
4 Cape Verde
5 Georgia
6 Ghana
7 Honduras
8 Lesotho
9 Madagascar
10 Mali
11 Mongolia
12 Morocco
13 Mozambique
14 Nicaragua
15 Senegal
16 Sri Lanka
17 Vanuatu

2006 Eligible

1 Armenia
2 Benin
3 Bolivia
4 Burkina Faso
5 Cape Verde
6 East Timor
7 El Salvador
8 Georgia
9 Ghana
10 Honduras
11 Lesotho
12 Madagascar
13 Mali
14 Mongolia
15 Morocco
16 Mozambique
17 Namibia
18 Nicaragua
19 Senegal
20 Sri Lanka
21 Tanzania
22 The Gambia
23 Vanuatu