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Mr. Chairman, thank you for the opportunity to testify today on the strengths and weaknesses of the Millennium Challenge Corporation, and to propose some changes in the authorizing legislation.

The Millennium Challenge Corporation was created by President George W. Bush as major reform in the international aid system, where we would reward those countries that made significant strides to improve their governance, economic freedom and expand investments in their people. President Obama has continued White House support for the program which indicates that the MCC business model has strong bipartisan support. More than ten years after the 102nd United States Congress passed the authorization for the MCC, we can take stock of its successes.

The MCC makes three major contributions to the international development practice. First, the MCC relies on transparent and readily available indicators to select countries for participation in compacts, which is advantageous in multiple ways – it makes the MCC effect possible, for one. Second, the MCC compiles the data it uses for selection in a scorecard of all twenty indicators, which it publishes for all countries for which is has data. This scorecard is now a valuable tool for private investors considering entry into a developing country. Third, and importantly, compacts are locally designed, driven and carried out with input from the MCC staff.

Local ownership of compacts is important because project success rates increase substantially when the management of projects is decentralized. Professor Dan Honig, at the John Hopkins School of Advanced International Studies, has shown a significantly higher success rate in aid projects where the local managers have a much higher degree of independence than those where management decisions are highly centralized. Over the past ten years there has been a significant centralization of decision-making in US government aid program in the State Department which has compromised the integrity and success rates of these programs, given the findings of Honig's research. The MCC has the last hold out in the federal foreign aid system to this creeping centralization, but it too is at risk.

The reality is, of course, that within certain bounds, recipient countries (and project managers in the field) are much better suited to make crucial decisions about how projects should take shape. With increased local participation and local management, it is also more likely that projects are carried through till the end – both because the project was tailored to local needs, and because local officials will take ownership of the projects. Moreover, the local implementation authorities created when a compact is awarded contribute to building the capacity of governments in the recipient countries. Accordingly, locally driven compacts will tend to be more sustainable in the long run.

One success story that is worth mentioning is the George Walker Bush Highway in Ghana, which was built with funding from the MCA. The highway is an embodiment of Ghana's success in its efforts to rapidly modernize its economy and political system. The highway has substantially improved market access in regions of Ghana that had been relatively isolated from international markets.

After ten years, we can conclude, with some assurance, that the MCC is a success story. We have certainly learned many lessons, but moving forward we should *refine* the MCC and not *reform* it.

In my testimony below are several suggested reforms to the MCC. The two most important improvements are the composition of the board – where the Secretary of State should not hold the chairmanship if we expect the MCC to live up to its mandate – and the use of the current corruption indicator, the purpose of which is more effectively carried out by the rule of law indicator.

Moreover, while the MCC is successful in its mandate, it is not an alternative to the United States Agency for International Development (USAID). The MCC is designed to only operate in the most ideal conditions – those where good governance, economic freedoms and investments in people have already been demonstrated. Much of USAID's work is specifically designed to operate under other and more challenging local conditions, as is necessary to fulfill its much broader mandate.

Strengthening the MCC is more important now than ever. The MCC compacts provide alternatives to Chinese loans and infrastructure development which do not encourage good governance or improved local capacity. The MCC has focused much of its funding on infrastructure, particularly in Africa, because that is what the people and leaders of the countries have chosen to focus their projects on. Donor government tend to appropriate money for sectors which are popular in wealthy countries, such as health, education, and the environment while what the developing countries need and want to build their economies are roads, bridges, and other infrastructure. When countries are left to make development decisions themselves, they prioritize these projects over social services because they know that we have forgotten that without economic growth and the tax revenues it generates, social services are unsustainable. Chinese aid is heavily focused on infrastructure and that it why it is so popular in the developing world. The MCC effectively rewards those countries that strive to achieve improvements for their citizens, but the relatively small budget of the MCC is dwarfed by China's efforts.

<u>The “MCC” effect</u>

A central and important difference between the MCC and other development agencies is the insistence on a commitment to good governance, economic freedom and investments in citizens in recipient countries. Potential recipient countries are well aware of the transparent, quantitative and objective thresholds that they must fulfil to qualify, which spurs reform and improvement in governance. Research by Bradley Parks and Zachary Rica (2013) found that policy makers in developing countries are sensitive to the eligibility criteria of the MCC, which acts as an external incentive to improve governance. The MCC effect is real, and it is a major contribution to the development community, where it will acts as an example for other aid agencies. I saw the MCC effect at work while I served on the Board of Directors as USAID Administrator.

Studies show that improving governance, economic freedoms and social opportunities for citizens is important for economic development – an idea championed by Amartya Sen, who received a Nobel Prize for his work – which shows the complementarity of these different areas to economic growth, development in general and poverty alleviation in particular. The idea is firmly rooted in theory and evidence, and several major studies have come out detailing the relationship, including the report by the World Bank, *Assessing Aid – What Works, What Doesn’t, and Why*.

The better countries score on these indicators, the more likely they are to successfully turn an MCC compact into economic growth, and the more likely it is that the economic growth benefits those citizens in poverty. However, improving governance, economic freedoms and social opportunities is also an end in itself for the twenty indicators the MCC uses to measure this. In fact, many of the indicators are measures of fundamental human rights, such as access to primary education, property rights and the right to participate in government. The MCC effect is such that even before funds are committed to a compact, the United States makes a difference in the lives of millions, with the promise of rewarding those governments that pursue these rights and freedoms for their peoples.

Recognizing that reforms and improvements in governance, economic freedoms and social opportunities can be costly, the MCC supports countries that have shown commitment to improving governance, but do not yet qualify for full compacts, by way of ‘threshold’ programs that assist governments financially to fund reform and improvements. The difficulty with the threshold programs is they are so small in funding and scope that their impact is limited. One refinement of the MCC would be to approve fewer threshold programs with larger commitments of money for longer periods of time which would increase their effectiveness.

While there is little doubt that the MCC effect is real, it is very difficult to measure the magnitude of the effect. The Office of the Inspector General of USAID funded a quantitative study by Johnson, Goldstein-Plesser and Zajonc (2014) of the effect, which yielded no conclusive evidence, one way or the other. Other studies have attempted to find a measurable difference between those countries we would expect to be affected by the MCC, and those that are not, with more but still limited success. However, in all cases, the authors point out that these results should not lead us to think the effect does not exist, but rather to conclude that we cannot yet measure it.

In my own research ("The Clash of the Counter-Bureaucracy and Development" published by the Center for Global Development, in 2010), I demonstrate how the focus on quantitative measures of success damages and distorts how we approach development because it ignores a central aspect of development theory – that those development programs that are most precisely and easily measured are the least transformational, and those programs that are most transformational are the least measurable.

This does not mean that we should stop attempting to estimate and measure our success, but instead that our *overreliance* on numbers and figures to evaluate development success is misleading and undermines good development practice. The OMB, the GAO, the IG, the State Department's Foreign Aid office, and Congressional oversight committees have forced both the MCC and USAID to collect massive amounts of program data which is never used by anyone and which does not actually demonstrate outcomes successfully. This entire system of aid oversight needs reform.

There are four distinct reasons why the MCC effect is difficult to measure. The first is simply that the tools we have available to do so are so crude that subtle, but important improvements in governance, economic freedom and social opportunities are too small for our tools to capture. The second issue is that many indicators that are used by the MCC on the scorecard, especially those relating to corruption and good governance (where the most important local reforms take place) are not appropriate for tracking change over time. Moreover, because the indicators are measured, collected and published by third parties (which is in other aspects a strength of the MCC indicators), a change in governance this year may not show up for a year or two, simply because measurement, preparation of the indicators, and publication, take time. But we also know from other research that many development programs display a time lag between the end of a program and the improvement in outcomes.

A third challenge is that the MCC is still a relatively small program, with a relatively modest budget. The threshold programs, which exist to help governments improve governance, economic freedom and social opportunities, by law accounts for less than 5% of the MCC's total budget. The current budget for the MCC is creating change, but we cannot expect *transformational change* – the profound shift of indicators – without committing at a higher level over a longer time horizon. If we hope for the MCC to have a great impact by catalyzing reform, then the compacts must be larger in size. The MCC can accomplish this within existing appropriations by approving fewer, but larger, compacts.

A fourth, and important challenge is the long time horizon associated with the type of change we are working to incentivize. Investments in anti-corruption this year, for example, will not substantially change the indicator the following year or two, even if the program is as successful as one could hope for. Many development outcomes, especially those relating to changes in governance, attitudes and business practices change slowly, and they are not always appropriately captured by quantitative indicators. Many of USAID's most successful governance projects showed results over a decade or two, not over months or years. As USAID has been gradually absorbed into the State Department, the length of development projects have become shorter and shorter, and that poses a significant threat to the efficiency and success rate of our foreign aid programs because there exists an inverse relationship between project length and project success. In other words, when projects are forced to work on a short time-horizon, development outcomes are adversely affected. During the Cold War, aid programs covered time-spans of 20 years, they gradually declined to 10 years, and while I served as USAID Administrator they declined to five years. Many aid projects today in practice last one year as they are constantly being reassessed as the State Department or OMB wants to free up money for some other diplomatic initiative.

Despite these measurement issues, it is still clear that the MCC effect is real. Passing the MCC's scorecard does not automatically lead to funding of a compact for the country, so the effect is more profound than reforms for the sake of securing funding. As a corollary to the MCC effect, passing the MCC's scorecard is an important signal to the private sector that looks to "passing" the scorecard as a seal of approval akin to the World Bank's 'Cost of Doing Business Index'. In the study by Bradley Parks and Zachary Rica (2013) at College of William and Mary, the MCC ranked as one of the three most influential external assessments of government.

If one relies on qualitative evidence instead, the MCC effect is even clearer. The MCC and others have provided testimony of instances where governments directly sought the MCC's guidance and assistance in overcoming governance obstacles, particularly with respect to corruption. Examples of a direct impact of MCC criteria range from Albania to Sierra Leone and Armenia. In Sierra Leone the government finally passed the scorecard in 2013 after years of reforms guided by the MCC and others.

It is important not to overstate the magnitude of the MCC effect, but it is a significant aspect of the MCC's success. So too is it important to recognize that the MCC effect is not the explicit goal of the MCC, which is poverty reduction through economic growth, but rather an additional outcome of the program beyond poverty alleviation.

The complementarity of the MCC and USAID

The MCC is not an alternative to USAID, and it is crucial that the MCC is not seen as such. The MCC has a more limited scope, concentrated in countries where we would expect development programs to be the most successful because good governance, economic freedoms and investments in human capital contribute substantially to economic growth. The ownership and local project management, which is important to the MCC model, is likewise only possible because the countries that pass the threshold are much more likely to possess the capacity to manage a compact than countries that do not qualify. While the MCC's single mandate is to alleviate poverty through economic growth, many mandates that cannot be achieved with MCC's model fall to USAID.

Among those mandates which fall outside the mission of the MCC is the work of the US Office of Foreign Disaster Assistance that provides humanitarian aid in complex emergencies such as conflict and famine, and the work of USAID's Office of Transition Initiatives, which supports US foreign policy objectives by supporting political transitions and supporting democracy building. Additionally, USAID was an indispensable leader in the US nation building efforts in Afghanistan and Iraq, and it will continue to be important for their recovery as well as in global health programs.

The MCC and USAID are thus complementary institutions that can reinforce the other's work, but they carry out fundamentally different tasks within the development process. USAID often operates in unstable conditions, where good governance is absent or has collapsed and where economic freedoms are a distant dream. Often USAID works in those environments to save and protect life, to enable basic markets to function and to prevent situations from deteriorating. The MCC, by its legal mandate, only operates in stable conditions and where markets function relatively well and is thus not a substitute for USAID.

Even in the countries that pass the MCC scorecard and where the MCC can thus operate, USAID fills many other roles than those relating specifically to economic growth. A third of the US government's foreign aid budget (much of it administered by USAID) is focused on global health, specifically on the world-wide eradication or treatment of different diseases such as Polio, HIV/AIDS, Ebola, and Malaria. USAID's very successful trade capacity building, "World Bank Doing Business" reforms, and economic competitiveness programs by their nature require policy dialogue with local business leaders and technical assistance which the MCC is not designed to do. In fact, while the MCC funds the threshold programs to assist governments in improving governance, economic freedoms and social opportunities, it is most often USAID that is contracted to carry out those programs.

Focusing on corruption

Of the twenty indicators on the MCC's scorecard, a single indicator reigns above the rest. Whereas countries must place higher than the median in half of the indicators to qualify, control of corruption is an indicator that a country **must** pass to qualify, no matter how good the average of the others indicators is. It is a difficult requirement, and rightly so, in recognition of how central corruption is to the economic, political and social maladies in poorly governed countries. We possess an abundance of evidence that corruption is bad for economic growth, bad for poverty alleviation and bad for political inclusiveness. President George W. Bush was the author of the requirement which he insisted be written into the legislation, and which has inspired anti-corruption reforms and campaigns in several MCC candidate countries.

We should continue to place a high premium on reducing corruption, but we can refine the MCC's ability to use the hard indicator as a tool for selection, and for inducing change in countries that wish to qualify. The current indicators for corruption are largely "perception"-based, meaning that if those surveyed perceive a high prevalence of corruption, then the country will score poorly on the indicator.

Perception does affect economic behavior, but it is only a minor part of what the indicator is actually attempting to measure. Because corruption is hard to quantify and measure (most people don't advertise their own corruption), the indicator uses perception as a way to estimate the full level of corruption in a country. It is what scholars would call a proxy – the use of an indicator that can be measured to extrapolate about a phenomenon that cannot. However, the perception aspect of the indicator can have unintended consequences that work against what the President and Congress designed the MCC to achieve.

One of the tools USAID uses widely to combat corruption is increasing public awareness of corruption and its destructive consequences, and educating people about how it can be dealt with. In many countries corruption is viewed as a way of life and not an aberration of government, which is a major obstacle to effectively combating corruption. However, raising public awareness about corruption – so it can be detected, reported, deterred and sanctioned – will also tend to raise the *perception* of corruption because the public is increasingly made aware of its presence and negative effects, and that increase in perception – even though corruption has not increased – is detrimental to the MCC's work. Simply put, with the current indicator, those countries that effectively improve on corruption can simultaneously be penalized for their efforts.

The solution is simple because the contributions of the hard target in the corruption indicator can be achieved with another established measurement: the Rule of Law indicator. Rule of law captures corruption in government through multiple measures, ranging from the independence of the judiciary and agents of the law, the impartiality, independence and accountability of the police force, the protection against government overreach in expropriation and so forth. The hard target for corruption should be based on this indicator instead. However, moving the hard target from the corruption indicator to the rule of law indicator requires the approval of Congress in any future refinement of the legislation.

Independence

On the matter of MCC independence, it is crucial that this be strengthened. The main benefits of the MCC's approach – the transparent, indicator-based system that spurs the MCC effect – depend on the MCC's credibility in using indicators for selection. The President's wish that the MCC would provide a new, innovative and effective kind of aid, based on hard evidence, is derived in part from the MCC's transparent and predictable methods. Another central facet of the MCC's success – local ownership, design and implementation of compacts – is indelibly linked to the MCC's ability to create sustainable capacity in compact countries. Anything but evidence-based selection of the best projects would undermine the MCC's work and the best use of aid funds in the MCC model. Recall that the MCC's mandate already ensures that aid is spent in the interest of the United States by focusing only on those countries that already have significant levels of political and economic freedoms and invest in their people.

In general, the involvement of the State and Defense Departments in specific *development and humanitarian aid* decisions has undermined the effectiveness of our aid, for USAID and the MCC alike. We have to make a very clear decision about whether or not our foreign aid is a grand strategy tool that we wish to employ to reward or punish other countries when they either support our goals or oppose them, respectively. Foreign aid is often used for entirely contradictory purposes--sometimes development for the purposes of development or other times as a tool of diplomatic and national security strategy. Hans Morgenthau argued this in his now famous 1962 article *A Political Theory of Foreign Aid,* where he suggested aid was given as a form of legal bribery to induce a change of diplomatic behavior on the part of the a recipient of the aid. On the other hand, we can decide – as the President and a bi-partisan Congress did when it authorized the MCC – that the purpose of our foreign aid is to create a stable, democratic and resilient world around us, which ultimately more broadly supports our foreign policy in profound ways.

South Korea is an excellent example that demonstrates the power of good development. Over the course of thirty years, USAID spent about 6 billion dollars (in 1960's dollars) in development programs to support economic growth and basic public goods such as sanitation, schools and infrastructure, which ultimately support economic growth as well. With the help of US government aid, South Korea rose out of poverty to be a prosperous, democratic and stable ally that is indispensable to the United States in preserving peace in East Asia. South Korea is a strong and active partner that keeps North Korea in check. However, USAID's work in South Korea would not have been as successful if it had been used to support of shorter and more parochial diplomatic objectives of US foreign policy.

Using aid as a bargaining chip might satisfy short term goals in some cases by buying the support of a warlord or important political faction, but it undermines the developmental use of aid to create prosperity and support the longer term interest of the United States. That should not come as a surprise: if aid allocation is not made based on the development potential, but instead based on political, short term priorities, then our development funds will not be effective. In such cases, of which there are many, USAID is then criticized for the lack of results in sub-optimal development programs that they are forced by the State and the Defense Department, and sometimes Congress, to design without regard for their development potential. In many cases these "development aid" funds are outright damaging our longer term goals. As USAID has been absorbed into the State Department, good development aid has become increasingly harder to do.

In fact, even the MCC is affected, despite the original intention of its mandate. As chairperson of the board, the Secretary of State has a disproportionate influence on compact decisions. Only one Secretary of State – Condoleezza Rice – shied away from making the MCC work for more parochial State Department objectives. She recognized that the independence of the MCC was one of its strongest attributes, even if the ultimate decision of the board did not align with her own preference. While it makes sense that the Department of State should be represented on the board, the Secretary of State should not hold the chairmanship. In fact, I would suggest an outside chairperson who does not hold public office as a statutory requirement. If the State Department wishes to reward an ally with aid for strategic purposes which is an important tool in a diplomats toolbox, they can use the Economic Security Fund account which was designed precisely for that purpose. I served on the US delegation at the Hong Kong trade round in 2005 and watched to my dismay as USDA and State Department diplomats attempted to promise MCC compacts to countries for supporting the US position in the negotiations on agriculture trade. I strenuously objected as the use of compacts for this purpose which in my view was an egregious violation of the intent and purpose of the MCC statute. These U.S. career officers backed down and the compacts were never promised.

Moreover, the intention of the President and the Congress of the United States was for the MCC to be entirely independent from political and strategic pressure, as was abundantly clear at the time of the MCC's authorization. When the State Department, or any other actor, affects compact or threshold decision outcomes, it is in violation of federal law and in violation of the original intentions of the MCC's founders. Several countries have been approved which clearly did not come close to meeting the indicators.

The independence of USAID and the MCC is imperative because developing countries put faith in the advice our development agencies offer. In many countries our aid agencies are well regarded and trusted, which occasionally leads aid workers having highly developed and influential relationships with government ministries and civil society organizations. If the perception among recipients is that our development programs are designed to serve U.S. short term strategy in mind, the work of USAID and the MCC will be made more difficult, even in the best designed projects.

I spent a while as a United States diplomat, so I have the utmost admiration for the State Department's work in diplomacy. In my view, our diplomats are among the best in the world. They should leave the management of aid development programs to development professionals in USAID and the MCC.

<u>**Operating in fragile states**</u>

The MCC faces challenges in countries where governance, economic freedoms and social opportunities are sub-optimal. In a few cases this fragility led to the early termination or suspension of compacts because the relevant indicators fell. While that is regrettable, I would argue that the termination and suspension of these compacts should be looked at as a success for the MCC. While the MCC could certainly improve its ability to help countries progress in governance, economic freedoms and social opportunities, as could all other aid agencies in the world, terminating the compact is not a symbol of failure but evidence of success in the rigor and discipline of the process. It is a victory for those countries that work hard to make real, sustainable improvements in their indicators.

If entry into a compact is based on a certain level of indicators that must be achieved, then those levels should be enforced after the compact has begun as well. Otherwise the improvement in the indicators is insincere; countries could improve to qualify, knowing that they could simply reverse reforms once the compact is granted. By enforcing the levels of the indicators after a compact is initiated, the MCC prevents opportunistic behavior. Enforcement is thus paramount to the MCC's mission of sustainable improvements in governance, economic freedoms and social opportunities.

Concurrent and regional compacts

A significant impediment to economic development is a lack of intra-regional infrastructure and cooperation. One particular category of countries – those that are landlocked – depend almost entirely on their connection with neighbors for access to the rest of the world, as demonstrated by Paul Collier in his seminal book, *The Bottom Billion*. In fact, the infrastructure projects including airports for landlocked countries is their connection to the global economy. Even for those with global market access, development tends to be closely related to the development of neighboring countries. Concurrent compacts would enable the MCC to operate in this crucial area of development, which is necessary for long run sustainable development in many areas, particularly in Africa.

A crucial aspect of economic development in many countries is market access: the greater a country's access, and the wider the market for its products for export, the more trade country a country can sustain. Inter-country trade improvements in particular can be beneficial to economic growth. If the regional compacts are carried out appropriately, the benefits that accrue are even beyond economic growth. With better connectivity, and cooperation in a compact, the MCC will assist in building bridges – literal and figurative – that will enable governments to increase cooperation in many areas, including security, politics, border control and epidemiological control, all of which are in the interest of the regions and the United States of America alike.

A regional compact would, of course, be a new type of challenge for the MCC. Whereas a traditional compact only has one qualifying government, regional compacts would by definition have more, and all governments should pass the thresholds for the regional compacts to be implemented. It also requires significant coordination between the administrating bodies set up in each country to handle the Millennium Challenge Accounts. While these factors would complicate the approval process, it would not make it impossible for regional compacts to be approved and managed.

The performance indicators

These indicators are an important aspect of the work the MCC does, and a fundamental requirement for the MCC effect. There are several aspects of the indicators that are worth considering, both to refine how they are used in the future and to understand their limitations.

Importantly, the indicators are used as a transparent and easily identifiable cut-off for eligibility. In theory, this means that compacts are only awarded to those countries truly committed to good governance, economic freedoms and social opportunities. It also means that countries have tangible goals they can work towards. Finally, the aggregate of the indicators – the MCC scorecards, which the MCC publishes for all countries that fall in the income categories every year – is also used by private and public actors alike to gauge how well a country performs in governance, economic freedoms and social opportunities.

As a whole, the general level across all indicators will provide an insight into country performance in these aspects. Once we look at individual indicators, however, it becomes more troublesome to gauge the current conditions, because some of the indicators simply are not precise enough. This lack of precision does not stem from a lack of effort to measure the indicators well, but rather from a lack of data and, more importantly, from the fact that many of these indicators are trying to capture things that are very difficult to quantify. Judging a country's performance, and especially comparing the performance between countries, based on a single indicator, is unwise.

Consequently, the indicators are only useful for the MCC's purposes as a grouping of indicators, the total of which forms the scorecard. Refinements can surely be made to the specific indicators used, but as a whole, the MCC's use of the indicators is in line with the original intention of the President and the Congress. Our biggest contribution to the MCC here would be to encourage the MCC to upgrade to new measures as they become available, but in a transparent and timely manner. For the corruption indicator however, Congressional approval is necessary.

The trouble comes when the indicators are used for other purposes than meeting the qualification threshold. Because the indicators are as crude as they are on their own, measuring the contribution of a threshold program for example– those designed to help countries in areas where they struggle – is difficult. What would be even worse is if we were to judge a compact based on whether it improved the indicators, because that is not the purpose of the compact – its purpose to is create economic growth and poverty alleviation. The indicators simply are not appropriate for evaluating the outcomes of programs, and they were never intended to be by the President and the Congress.

Moreover, the use of the indicators as a measure of the success of any development program is problematic. Beyond the time-lag in measurement mentioned above, another and much more important time-lag exists. To put it simply: development takes time. Attempting to quantify the success of programs in the next fiscal year is often nonsensical. In the case of South Korea, USAID helped lay the foundation that eventually enabled the South Korean economy to soar; the true extent of the benefits from USAID programs in South Korea were not known for at least two decades. With respect to governance and social opportunities in particular, perceptions and attitudes are among the major impediments to improvements, but perceptions and attitudes take a long time to change. Even where the MCC provides the tools for positive change, much of the benefit will not materialize for years.

A related issue pertains to the difference between output and outcomes in development. Output is oftentimes easy to measure: how many miles of road built, how many farmers trained, how many village councils established? However, what we ultimately want to know--what we term outcomes--is whether the road improved market access and reduced poverty, whether the farmers that were trained translated their training into improved crop yields or whether the village council were in fact inclusive and effective at using their mandate. Measuring the output does not guaranty a good outcome – nor does the absence of outputs mean that there cannot be successful outcomes. The over-measuring of development thus yields little useful information and instead creates a significant amount of paperwork that serves no good purpose.

The MCC began with 17 indicators, and three more have since been added to the MCC's scorecard. It is hard to disagree with the indicators, either because they are morally important, or because we believe a new indicator is connected to economic growth. If we know the phenomenon that the indicator measures is important to economic growth, why should we not include it on the scorecard? The answer is again that the fixation on measurement is hurting the MCC's ability to carry out good compacts, and it also causes undue stress on the governments vying for a compact. Because the scorecard should be read as a whole and not as individual indicators, adding more indicators does not necessarily improve compact selection – it does, however, mean that potential recipients have to spread their already sparse government capacity to more indicators. This dilutes the efforts that governments are able to expend on individual areas, hurting progress. Most developing countries have limited capacity and weak institutions – even the ones which rank high in the indicators – which means their capacity to reform and make improvements in their countries have limitations. Piling one indicator on top of another will overwhelm their capacity to focus their efforts on a few reforms of the greatest significance. And, it creates a greater burden on MCC to compile and publish the scorecards with a greater number of indicators.

Without arguing that any specific indicators are unimportant to economic growth, we should reduce the amount of indicators on the scorecard (or at least freeze the number of the indicators at their present level) to improve the effectiveness of the scorecard on governments' behaviors and to reduce the adverse effects over-measurement will have on potential recipients.

The MCC's reliance on a certain level of several indicators has led some observers to be concerned with the 'conditionality' of MCC compacts, because conditionality was the main culprit behind the failure of much aid spending from the World Bank and other agencies in the

1980s and 1990s. However, the conditionality of the MCC is fundamentally different in several ways.

First, MCC conditionality takes place before compact-signing and without guarantees that a compact will be awarded, by excluding those countries that do not meet the requirements for application. Applying for a compact and moving towards the indicator levels is entirely voluntary – if a country does not find it in its own interest to enact the reforms necessary, it is not adversely affected, except by foregoing the potential funding.

In that same vein, the MCC's conditionality does not force specific policy prescriptions on countries. The MCC's conditionality is an "end goal" of a certain level in the indicators, as opposed to specific methods for reaching that goal. The World Bank prescribes specific (and sometimes inappropriate) policies that countries are forced to follow, but for the MCC indicators, it is largely up to countries to decide *how* to improve the indicators in ways which are most compatible with local circumstances.

Moreover, World Bank (and International Monetary Fund) conditionality in the 1980s and 1990s was often enforced for countries eligible for loans without which the recipient governments could not function, such as loans to sustain basic public goods or loans to help stabilize a country's currency during a time of crisis. Countries had very few choices but to accept the conditions, since without the loans and grants, the situation could deteriorate past a point of no return. In practice countries would agree to a laundry list of World Bank reforms which they would not end up implementing. In the case of the MCC, compacts cannot be held ransom in the same way, because they are designed to be above and beyond other efforts by USAID, the World Bank and other aid agencies, and because the compacts are not designed to sustain governments, but rather to create economic growth and reduce poverty.

In conclusion, the MCC has demonstrated success in achieving President Bush and the Congress's original aspirational goals of the authorizing legislation, but the legislation can be refined with some of proposed amendments suggested in this testimony. Thank you for the opportunity to speak today.