



**Testimony before the
International Relations Committee
United States House of Representatives**

**“THOUGHTS ON A SOCIAL INVESTMENT
FUND FOR THE AMERICAS”**

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A Statement by

Patrick M. Cronin
Senior Vice President and Director of Studies

**CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, 1800 K STREET, NW, WASHINGTON, DC 20006
TELEPHONE: (202) 887-0200 FACSIMILE: (202) 775-3199 WWW.CSIS.ORG**

Chairman Ballenger, Ranking member Menendez, members of the Western Hemisphere Subcommittee, thank you for inviting me to testify before this distinguished body on important issues of public policy regarding the western hemisphere. I have been asked to comment on how to forge effective strategies to help nations in Latin America and the Caribbean improve social development and provide broader, more equitable opportunities for their citizens to participate and prosper in the globalizing economy.

After two years of helping to shape our government's development policies and observing our work on the ground around the world as the Assistant Administrator for Policy and Program Coordination at the U.S. Agency for International Development, I have some thoughts about how to pursue successful economic growth and poverty reduction. In particular, my role in leading an interagency working group to help establish a Millennium Challenge Corporation has left a deep impression on me regarding the need to not knowingly repeat the mistakes of the past and the felt need to incorporate the best practices and lessons learned into our development policies. This experience, I believe, has direct bearing on development policies around the globe, including Latin America and the Caribbean.

Please permit me to begin by characterizing the challenges we face in our own hemisphere with respect to development. The fact that the vast majority of countries in our region are classified by the annual United Nations Human Development Report as having "medium" rather than "low" development, masks both the pervasiveness of poverty and the opportunity to advance democracy and economic growth.

Western Hemisphere at a Glance

At the macro level of public policy, the Latin America and Caribbean region faces ongoing development challenges that threaten the national security and economy of the United States. Contracting economic growth rates, extensive poverty, unemployment, the skewed distribution of income, crime and lawlessness, a thriving illegal narcotics industry and a deteriorating natural resource base continue to undermine the stability of the region. The region's Gross Domestic Product (GDP) shrank by approximately 0.8 percent in 2002. This represents the region's worst economic performance in two decades. In 2002, inflation reached 12 percent after eight years of steady decline. Mediocre economic performance has caused per capita income in this region's countries to decline significantly

since 1998, while poverty has been on the rise. These challenges have brought discontent and political turbulence, and they have shaken citizens' faith in democracy, investment priorities, social sector policies, and the benefits of a decade of liberal reforms. The effects in the poorest countries, such as Haiti, and even in regions of countries with generally solid economic performance, such as northeast Brazil, have been more disheartening.

Still, it is important not to portray the region in an entirely negative light. Overall GDP is expected to grow by 1.5 percent in 2003, and inflation is on track to return to single digits this year.

The United States now imports \$240 billion in products from Latin America and the Caribbean annually. In addition, our direct investment in the region totals about \$270 billion. Remittances flowing from the United States to the region amount to another \$25 billion. All told, that income and investment is 120 times the total U.S. economic aid to the region—something to bear in mind as we think about leveraging aid programs. Foreign aid, no matter how plentiful, must be used as a strategic catalyst if it is to have the most benefit.

U.S. Development Focus

The U.S. Agency for International Development (USAID), the principal governmental agency providing development assistance to the region, is working closely with the State Department, and to varying degrees with other parts of the U.S. government and multilateral institutions, on three priorities: (1) promoting democracy and combating corruption; (2) supporting trade-led economic growth; and (3) reducing illegal narcotics trafficking. These key themes give paramount importance to the implementation of sound policies that address the principal constraints to development, with the overarching goal of furthering U.S. foreign policy.

The USAID Latin America and Caribbean Bureau's strategy is being carried out through three major programmatic and management approaches, one for each of three sub-regions: the Central American and Mexico (CAM) Regional Strategy focuses on trade-led development and the Central America Free Trade Agreement (CAFTA); the Andean Counterdrug Initiative focuses on counternarcotics; and programs in the Caribbean region combat HIV/AIDS and promote growth and diversification in small island economies. Because countries within each of the sub-regions face similar key development challenges, USAID is developing regional strategies to provide a single framework for both regional and country-

level programs. In Central America and Mexico, USAID has already launched a new joint regional strategy focused on three goals that mirror the main themes of the Millennium Challenge Account: transparent governance, economic freedom, and social investment.

In addition to country-specific and regional activities, USAID is addressing critical transnational issues such as HIV/AIDS, a deteriorating natural resource base, trafficking of persons, and inefficient education systems. USAID is also committed to mobilizing resources from and fostering alliances with both the public and private sector.

The Social Investment Development Fund

At a basic human level, compassionate Americans cannot but be moved by the crying need for humanitarian assistance in Haiti (one of the few countries in the region that ranks below Sudan and Congo in human development). Similarly, ample are the heart-wrenching stories about the destitute Bolivian mother bereft of resources for her children, or the well-meaning local official in Honduras lacking the means to keep children in school (where 25 percent of “adults” over 15 are illiterate). While ultimately our development programs must be measured against tangible human progress, the fact that policy makers focus on larger public policies does not make them any less passionate about progress; instead, general policy initiatives must be understood as an attempt to address systemic and underlying problems and to find ways to break the cycle by promoting economic growth and therefore sustainable development.

It is this two-level approach--wanting to improve the lot of those in our hemisphere and desiring to create lasting solutions--that causes me to have mixed reactions to the proposal for a new Social Investment Development Fund for the Americas. On the one hand, I applaud those who are not satisfied with the status quo and seek action on behalf of the poor in underdeveloped countries in our region. Similarly, I welcome the notion of adding more resources to our spending on foreign affairs, including development in general. On the other hand, this proposed fund falls far short of incorporating the lessons of the past to ensure that tax money leads to sustainable development, thus breaking the vicious cycle of poverty. Here I must question whether the social fund as proposed would represent new and additional resources or simply detract from other priorities; whether it would be a more effective way than proposals already on the table—namely the Millennium Challenge Account—to promote social and economic development in this and other regions; and whether this proposal represents the

best way to work with the interagency and the international community to promote coherent and effective development policies based on past experience.

Five Problems with the Proposed Fund

There are five interrelated problems with the proposed fund.

- 1. The first problem is that the funding for a new social investment fund is likely to come at the expense of other development and foreign policy priorities.** Private financial flows, trade, and investment dwarf development assistance. Aid, in fact, is better suited to being a catalyst than a stand-alone fund trying to tackle the enormous challenges of under development by itself. Within USAID, if the fund were to lead directly to an increase in the Latin American and Caribbean Bureau, this would be a good thing. However, having had responsibility for the USAID budget, I fear the funds would simply be subtracted from or offset by cuts elsewhere in the 150 international affairs account or cuts elsewhere from the USAID-managed accounts. Thus, in the name of helping development, this proposal could have the unintended effect of undermining poverty-reduction strategies in the poorest countries on earth or other pressing foreign policy interests. Because we have important global interests, including the current need to focus on post-conflict reconstruction in Afghanistan and Iraq, and to think through long-term approaches for countering international terrorism, we must make the most effective use of our relatively scarce development funds.
- 2. A second drawback to the proposed fund is that it would further confuse an already convoluted and fragmented bureaucracy for delivering foreign aid.** When the OECD Development Assistance Committee undertook its most recent peer review of U.S. development assistance programs last year, it concluded that some 50 departments, agencies and offices claim authority for foreign aid programs. In the past three years, the Bush Administration has tried a two-prong approach to repairing the problems of cross-cutting lines of authority and ambiguous accountability: it has pulled USAID into a closer relationship with the State Department; and it has created new coordinators (as for HIV/AIDS or Afghanistan) and new entities (as with the Global Fund for AIDS, Tuberculosis and Malaria or the proposal for a U.S. Millennium Challenge Corporation whose CEO would report to the Secretary of State as chairman of an interagency board) in order to ensure accountability and overcome an

accumulation of bureaucratic obstacles that prevent the delivery of effective aid in the field. While I believe the Nation must move even further than this and consider, at the appropriate time and with a thorough national dialogue, the rewriting of the 1961 Foreign Assistance Act, I would also refrain from adding to this confusion by establishing a fund that would lack the monitoring and evaluation measures and transparency envisioned in the Millennium Challenge Corporation. Furthermore, I would also be wary of the shortcomings of any Technical Review Committee, whose members would not be free from vested interests. One of the problems we face now in development is that so much of our money goes through the “usual suspects” rather than through the partner institutions best poised to deliver aid effectively. Effective aid delivery includes not simply inexpensive delivery, but also the ultimate impact left behind, including the building of an indigenous capacity.

3. **Thirdly, the proposed fund would perhaps help address specific social needs, but it would do little to ensure aid effectiveness on the basis of experience.** Development specialists generally acknowledge that aid works best where there is political will and a favorable policy environment defined largely in terms of political and economic freedom. This was recognized at the United Nations conference on “Financing for Development” held in 2002, when President George W. Bush elaborated on his proposal for a Millennium Challenge Account. Moreover, the President not only built in selectivity to help ensure poverty reduction, he also sought to ensure that MCA grants would help focus on a finite set of issues intended to remove major impediments to productivity, thus leading to sustainable economic growth. As President Bush said in May of 2003 during his commencement address to the U.S. Coast Guard Academy, “The lesson of our time is clear: when nations embrace free markets, the rule of law and open trade, they prosper and millions of lives are lifted out of poverty and despair.” The proposed social fund, in stark contrast, would use no criteria for deciding where to invest scarce development resources; this is the old model of aid that both developed and developing countries rejected in Monterrey, where they reached a new consensus rooted in the notion of “more aid for better governance.” Incidentally, of the five countries from the region that would be eligible for a Millennium Challenge Account grant in fiscal year 2004, four are extraordinarily strong contenders. Only Haiti clearly falls short of the mark; the rest seem to confirm that the Millennium Challenge Account is geared to better performing states like those of our neighbors.

- 4. A fourth problem with the proposed social fund is that it would fail to help mobilize other donors.** Congress should not put half a billion dollars in the Inter-American Development Bank (IDB) to be distributed by the Board in the absence of firm agreements from other donors to at least match the U.S. funds. The idea of the multilateral development banks is to promote burden sharing, and unilateral U.S. contributions do not accomplish this. For instance, it is worth noting that under the Multilateral Investment Fund at the IDB, the United States and Japan each committed up to half a billion dollars, and the Europeans contributed about \$280 million among them; in short, the United States leveraged a lot of money for a good purpose, such that we were comfortable with turning over control over U.S. funds to someone else. Once again, in contrast to the social investment fund proposal, which would be seen as one more disconnected fund, the Millennium Challenge Account would help to restore U.S. leadership in international development. Moreover, the MCA's strong intellectual foundation built on lessons learned would, if given a chance, resonate with most other bilateral and multilateral donors. Indeed, there is ample evidence that both the World Bank and other bilateral donors are rushing to demonstrate their similar desire for economic growth, private sector development, and results-based management.
- 5. Fifth and finally, the social fund would do nothing to remove the contradictions in our development, economic, and trade policies that work at cross-purposes with respect to helping under-developed countries.** These countries generally seek broader access to U.S. markets. Thus, those who oppose liberalized trade should think twice about their positions against CAFTA/FTAA because it means protected U.S. sugar markets and protected textile markets (while quotas get removed on the rest of the world, including China). As the American Textile Manufacturers Institute has shown, we must consider the damage done to U.S. national security when we think of jobs saved in the United States at a very high cost to the American consumer and the economy at large

Some Alternatives

Rather than pursue the proposed fund, I would recommend considering the following ideas:

- **First, support the immediate authorization and funding for a Millennium Challenge Corporation, giving it broad flexibility in**

exchange for transparency, accountability and measurements. The Congress should exercise critical oversight with respect to the MCA contract, investments and performance, ensuring transparency throughout the process. If the desire is to provide money to more countries in the region, then Congress could consider enlarging the pool of eligible countries to the number envisioned in 2006—a move that would more than triple the number of countries eligible from the western hemisphere.

- **Second, strengthen the ability of USAID to follow the lead of the Millennium Challenge Corporation with respect to a fresh approach to development.** Foreign assistance achieves results in those countries committed to progressive economic policies and strong democratic institutions. Based on a subset of the criteria of the MCA, USAID's regional bureau has revamped the way it allocates resources based on performance. It has also set up a performance fund. USAID LAC Bureau requested \$25 million for fiscal year 2004 that would be allocated to a small set of countries based on the subset of MCA criteria (12 out of the 16 indicators). Congress should consider a way to provide funding for this complementary initiative, but at a level not likely to be detrimental to other urgent programs. By linking the USAID more directly to the concepts underpinning the Millennium Challenge Account, one can bring about badly needed positive reforms within USAID.
- **Third, direct the State Department and USAID to collaborate on a single report that charts the contributions of U.S. tax money, at least, toward accomplishing the goals of the Millennium Declaration goals in general and in the western hemisphere in particular.** While UNDP charts these internationally, we should know what part the U.S. is contributing, too. No one in the U.S. Government currently tracks this systematically, although I launched a process within USAID to do this before I left. The information in the report could provide a valuable basis for public debate about future assistance to the developing world.

Conclusion

We would all like to see enhanced funding levels for Latin America and the Caribbean, and I fully support the proposed objectives set out in the draft. But the resources desired will compete with other priorities and approaches, the proposed fund further confounds the desire for clarity with respect to accountability and effective implementation, other donors would have few incentives to follow our

lead, and the problem of policy incoherence would not be improved. For all these reasons, I recommend that we embrace other models for effective aid delivery and U.S. leadership in development. Above all else, we should move forward to authorize and fund the President's proposal for a Millennium Challenge Corporation.

In contrast to the proposed social investment fund, the Millennium Challenge Corporation would allow the American people to support the efforts of developing countries in raising their standards of living and reducing poverty. Furthermore, the Millennium Challenge Corporation would focus on the most promising partnerships: *viz.*, countries that govern justly, invest in their citizens, and encourage economic freedom. These are policies and practices that so many countries in our region share, and providing the best performing countries with additional assistance would not only provide further incentives to promote the rule of law, root out corruption, protect political freedoms, and invest in education and health care, but also encourage open markets, sound fiscal and monetary policies, and private enterprise. Because the Millennium Challenge Corporation would work with each country on its vital development needs, it would build in partnership and local ownership

We share a common challenge in helping the under-developed world achieve greater prosperity and opportunity for all their citizens. I look forward to supporting you in any way that I can as you continue to help the Nation think through creative and constructive policies for grappling with these challenges. Thank you.