FOREIGN ASSISTANCE IN THE AMERICAS

HEARING

BEFORE THE

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THE WESTERN HEMISPHERE

OF THE

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FOREIGN ASSISTANCE IN THE AMERICAS

TUESDAY, SEPTEMBER 16, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE WESTERN HEMISPHERE,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:44 p.m. in room 2172, Rayburn House Office Building, Hon. Eliot L. Engel (chairman of the subcommittee) presiding.

Mr. ENGEL. A quorum being present, the Subcommittee on the Western Hemisphere will come to order. I am very pleased to welcome everyone to today's hearing on Foreign Assistance in the Americas.

As you know, Chairman Berman has announced his intent to rewrite the Foreign Assistance Act in the next Congress. I commend the chairman for his leadership in taking on this long overdue endeavor. Those of us who have been on the committee for years have felt it was long overdue. The purpose of today's hearing is to begin to think critically about what reforms in foreign aid should be made here in the Western Hemisphere.

Before I present my opening statement and offer members on the subcommittee an opportunity to do the same, I would like to first call on our first witness, my good friend, someone who is no stranger to this particular committee room, Senator Bob Menendez, who is chairman of the Senate Foreign Relations Subcommittee on International Development and Foreign Assistance, Economic Affairs and International Environmental Protection.

Senator Menendez, welcome back to the House and especially to your former home here on the Western Hemisphere Subcommittee where you were the ranking member. I wanted you to go to the Senate because I thought you would make a great Senator, but I was very interested in stepping into your shoes to become the ranking member after you left. So I had a double reason for wanting you to get elected. And my good friend, Mr. Burton, who was the chairman at the time, is now the ranking member. So, you know, this seems to be a bit incestuous, but we are happy to have you back anyway.

As most of you know, for longer than I can remember, Senator Menendez has taken enormous leadership in calling on successive U.S. Presidents to increase the flow of foreign aid to our friends in the Americas. For a number of years, he has authored legislation, first here in the House and then in the Senate, which would significantly increase aid to the hemisphere.

In this Congress, Senator Menendez offered the Social Investment and Economic Development Act for the Americas of 2007 which would provide $2.5 billion in new aid to Latin America and the Caribbean over the next 10 years. I am proud to be the House sponsor of this bill, along with our ranking member, Dan Burton.

So Senator Menendez, welcome to the subcommittee; and the floor is yours.

Mr. PAYNE. Mr. Chairman.

Mr. ENGEL. Yes.

Mr. PAYNE. Although we are going to do away with opening statements, I would like to as a New Jerseyan—and I have more seniority than my colleague, so I am usurping him, although he replaced Senator Menendez in the House—would just like to welcome the Senator to the House and would just like to commend him for the outstanding work that he has done as it relates to Latin America, the Caribbean in general and just policies throughout the country. And so I would yield back but felt it necessary.

Mr. ENGEL. Mr. Payne, since you made a quick statement, I will let everyone, with the Senator's indulgence, make a quick statement. And the gentleman who replaced him, Mr. Sires.

Mr. SIRES. Well, I also had an interest like you had for Senator Menendez to succeed. So I am very happy that you are in the Senate. But there is no way you can replace Bob Menendez. So just welcome and nice to see you.

Mr. ENGEL. And our ranking member, Dan Burton.

Mr. BURTON. All you guys from that State? Man.

Well, Bob Menendez, Senator Menendez, as well as our current chairman have been very, very good people to work with. Bob and I worked on legislation when he was in the House, and he was my ranking member. And even though we had some political differences I really enjoyed working with him, and I think he is one of the finest Senators we have in the country, in the Senate. And I just wish he would change to Republican, but, unfortunately, that is probably not going to happen.

Mr. ENGEL. Congressman Weller.

Mr. WELLER. Well, thank you, Mr. Chairman.

And first let me just say thank you for allowing me to join you again today, since I am not a member of this subcommittee, to be able to sit in on the hearing. And I welcome the opportunity to hear from my good friend from New Jersey and former colleague on the subcommittee when I served on it. And like my friend, Dan Burton, I commend you for the work you are doing; and I look forward to your presentation.

Thank you.

Mr. ENGEL. Thank you.

So now, Senator, I want to ask you, since my district borders on New Jersey, do I get to make a second statement before you make yours?

Senator MENENDEZ. Mr. Chairman, you are the chairman. You can do anything you want.

Mr. ENGEL. See how much wisdom he has being in the Senate for a short time?

Senator Menendez, it is all yours. The floor is yours.

STATEMENT OF THE HONORABLE ROBERT MENENDEZ, A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator MENENDEZ. Thank you, Mr. Chairman.

Thank you for your gracious introduction and those of the distinguished members of the committee. Thank you for your invitation to be here before a committee which I had the privilege of being the ranking member with Congressman Burton who at that time was the chair. We worked together very well on a series of issues, as I am sure you are both working together now on U.S. interests in terms of this hemisphere. I appreciate both of your leadership in this regard, and I appreciate both of you as well as several other members of the committee in sponsorship of the legislation that you talked about.

I would ask that my full statement be included in the record.

Mr. ENGEL. Without objection.

Senator MENENDEZ. And I appreciate this opportunity to come back home in a sense and talk a little bit about something that we all mutually care about.

I especially appreciate the opportunity to discuss U.S. foreign assistance in the Americas, and I want to lay out what I think are the key issues which compel us to invest more in our hemisphere, in the national interest and in the national security of the United States. Issues that we debate here in Congress every day are intertwined. Issues of immigration, people leave their country for only two reasons: Dire economic necessity or civil unrest. Questions of gangs that have now spread hemispherically, narcotics, the spread of disease, biodiversity and environmental protection, global warming and making sure that terrorism doesn't take root in our own front yard, these are all reasons why I believe we, as Americans, beyond being good neighbors should be robustly inclined to make a significant investment in the hemisphere. These efforts are all connected, and they are all geared toward making a stable community of sovereign nations hopefully with a larger, growing middle class, a middle class which would have an appetite for U.S. goods and services.

So I want to structure my remarks around three areas: One, why foreign assistance to the Americas is important; two, why it is not an easy task; and, three, how we can do it much better.

First, while Latin America and the Caribbean have seen positive aggregate economic growth in the last several years, poverty, inequality and the lack of opportunity remain widespread. And given the limited time today, I want to focus a few comments around inequality.

I know this committee doesn't need to be reminded, but sometimes it is good to emphasize that chronic and structural inequality is alive and well in the 21st century and particularly in the Western Hemisphere. The 2008 world development indicators compiled by the World Bank states that the richest 20 percent of Latin America receive 57 percent of the total income. So the richest 20 percent receives 57 percent of the total income, while the poorest receive less than 3 percent. This makes Latin America one of the single most unequal regions in the world with sub-Saharan Africa. A January, 2008, World Bank report states that inequality "extends to every aspect of life, from the distribution of income and assets to access to education and health services and political voice and influence."

So when we talk about addressing inequality, let me say what we are not talking about. In my mind, we are not using a buzzword from the past; and it is not old thinking about liberal or leftist ideas. It is not about stealing from the rich and giving to the poor, and it is not about trying to prop up antiquated economic models that don't work. It is about everybody paying their fair share and everybody sharing in fair pay and opportunity.

Most importantly, inequality is a destabilizing force. It is a destabilizing force not just in Latin America but certainly throughout the world. So it is both in the national interests of the United States and in the national security of the interests of the United States to address anything that is a destabilizing force, particularly in our own hemisphere.

Market-based economies and democratic societies, and the opportunities that those systems bring, are the best hope for the region's future—when those systems are functioning well. Our collective challenge is that we need to make these systems work. They are imperfect, they don't work right away, and they certainly don't work out of the box. They need to be glued together very carefully. And the glue that will hold them together over the long term is the political and economic institutions in the region.

This is where our assistance comes in. Institution building in my mind is the core of foreign assistance. Building institutions is hard to measure, and we don't see changes right away, and we are a society that wants to see instantaneous gratification. But institution building takes a little more time to see the results. But it is really what we are trying to do when we try to help get kids into school, get teachers into schools, help ministries of health provide basic services and help ensure that those services are reaching the most vulnerable in those societies. When we build a workforce, bring in civil society, stabilize an investment climate and increase participation in the political process, we are building institutions.

Now, why is this difficult? There are several reasons.

First, our overall engagement outside of our borders has been anywhere from controversial to, in some places, I think, disastrous. Our lack of active engagement in the region has also put us in a difficult position, as evidenced by the events of the last week. We have in many respects created a vacuum, and that vacuum has been filled by others with rhetoric and petrodollars.

With respect to foreign assistance, we have some specific challenges that I want to outline; and I spent a lot of time on this as the chairman on the Senate side of our Foreign Assistance Subcommittee.

Our Government's ability to effectively manage and implement foreign assistance programs I think has been in decline for decades. And as the chairman of the Foreign Assistance Subcommittee I am working to build up our ability to do this, and I look forward to working closely with this committee and Chairman Berman to build us back not simply to where we used to be. That is not my standard. It is where we need to be, not where we just were, but where we need to be in our own interests.

USAID's staff is stretched too thin, and their programs are getting pulled in too many directions. Without strong leadership and a clear vision and highly capable staff to carry out that vision, we risk a formulaic application of off-the-shelf ideas. Well, as we all know, in this business, formulas don't always give you the results you expect; and sometimes ideas were shelved for a reason.

Some have pointed to the increases in remittances, for example, in the hemisphere and private investment as a justification for decreases in development resources. However, remittances and private investment are not institution building; and they are not a replacement for well-targeted, smart investments in systems of justice, health or education.

The Millennium Challenge Corporation and the Merida Initiative are two recent programs that I have been watching closely. I am sure you have as well. I have included additional comments of these programs in my written statement. But I will say that with both programs I have enthusiasm and also some concerns, and I look forward to staying actively engaged, moving forward on both of those.

And, finally, how can we do this better? First of all, governments cannot do this alone. We need to continue to expand the people with whom we coordinate, both in civil society and in the private and philanthropic centers. We should also think more about regional solutions to regional problems. The hemisphere is brimming with talented people who understand how to build institutions. We need to take better advantage of this talent and broaden our partnerships.

One of my efforts, along with my Republican colleague, Senator Martinez of Florida, and that the chairman has mentioned and the ranking member is a cosponsor of as well as other members of this committee, is the Social Investment and Economic Development for the Americas Act. That bill has 13 cosponsors, both Republicans and Democrats. It was reported favorably out of the Senate Foreign Relations Committee this year.

The bill provides $2½ billion over 10 years for social and economic development in Latin America, using both USAID and the Inter-American Development Bank. The goals include nurturing public/private partnerships and microenterprise development, reducing the time and cost of starting a business, increasing access to credit, improving the investment climate, strengthening the rule of law and reducing poverty. The approach is to multiply the impact of U.S. investment through the creation of a matching fund for the private sector and member countries of the Bank.

The bill requires a 10 percent contribution from the recipient country to allow them to take ownership of the projects; and, also, the bill implements a rigorous, rigorous evaluation and oversight system through impact assessments and an advisory committee to review all of these projects.

These efforts in part will help expand helping those begin to close the gap between the great inequality that exists. It will not, obviously, on its own do that. There are a lot of other elements that have to take place. But it is one initiative to do that, and it will pay dividends back to the United States by creating more customers for U.S. goods and provide a foundation for long-term economic and political stability in the hemisphere.

I can't tell you how many companies have come to me who have made investments in the hemisphere only to find out that the rules of the game changed, the lack of transparency that exists, the judicial entities that they have to pursue in order to make sure their contract is honored and then find themselves in a judicial system less than worthy of their commitment and investment.

That is bad for Latin America. Obviously, bad for U.S. companies as well. Because if that is the image that you give, then investment won't follow. And so there is a mutual interest here in strengthening these institutions and at the same time creating those opportunities.

So, in conclusion, Mr. Chairman, I support efforts to increase our foreign assistance to the hemisphere. However, let me be clear neither my bill nor additional resources are going to fix everything. Foreign assistance does have its limit, but we have not yet even approached that limit. More resources and better-spent resources, combined with active diplomatic and economic engagement, will help build the institutions that will create more stable political, social and economic systems. Only once we recognize that the success of those systems is deeply connected to our own interests, both in terms of overall national interests and national security interests and to our own successes, will we begin to adequately address the joint challenges that threaten both our national security, our economy and our way of life.

And with that, Mr. Chairman, I appreciate the opportunity. If there are questions, I am happy to answer them.

Mr. ENGEL. Okay. Thank you very much, Senator.

[The prepared statement of Senator Menendez follows:]

PREPARED STATEMENT OF THE HONORABLE ROBERT MENENDEZ, UNITED STATES SENATE

Chairman Engel, Congressman Burton, and distinguished members of the committee, I am pleased to be able to testify before this subcommittee, a subcommittee that I had the honor of serving as the Ranking Member. I especially appreciate the opportunity to discuss U.S. foreign assistance in the Americas.

First, I want to lay out the key issues which compel us to invest more in our hemisphere. Issues like immigration, gangs, narcotics, the spread of disease, biodiversity and environmental protection, global warming, and making sure that terrorism does not take root in our own front yard. These efforts are all connected and they are all geared towards developing a stable community of sovereign nations with a larger middle class—a middle class with an appetite for U.S. goods and services.

I want to structure my remarks around three areas: 1) why foreign assistance in the Americas is important, 2) why it is not an easy task, and 3) how we can do it better.

First, while Latin America and the Caribbean have seen positive aggregate economic growth in the last several years, poverty, inequality, and lack of opportunity remain widespread. Given the limited time today, I want to focus a few comments around inequality. I know that this committee doesn't need to be reminded, but sometimes it is good to emphasize that chronic and structural inequality is alive and well in the 21st century, and in particular in the Western Hemisphere. The 2008 World Development Indicators compiled by the World Bank states that the richest 20 percent in Latin America receive 57 percent of the total income, while the poorest receive less than 3 percent. This makes Latin America one of the single most unequal regions in the world, along with Sub Saharan Africa.[1] A January 2008 World Bank report states that inequality "extends to every aspect of life, from the distribu-

[1] World Development Indicators 2008 Fact Sheet

tion of income and assets to access to education and health services, and political voice and influence."[2]

When we talk about addressing inequality, let me say what we are *not* talking about. We are *not* using a "buzz word" from the past, and it's *not* "old thinking" about "liberal" or "leftist" ideas. It's not about stealing from the rich and giving to the poor—and it's not about trying to prop up antiquated economic models that don't work. It's about everybody paying their fair share, and everybody sharing in fair pay.

Most importantly, inequality is a destabilizing force, not just in Latin America, but throughout the world. So, it is both in the national interests of the United States and in the national security interests of the United States to address anything that is a destabilizing force in the world.

Market-based economies and democratic societies, and the opportunities that those systems bring, are the best hope for the region's future—when those systems are functioning well. Our collective challenge is that we need to make these systems work—they aren't perfect, they don't work right away and they certainly don't work "out of the box"—they need to be glued together very carefully. And the glue that will hold them together over the long term, are the political and economic institutions in the region.

This is where our assistance comes in. Institution-building is at the core of foreign assistance. It's hard to measure, and we don't see changes right away, but it's really what we're trying to do when we help get kids into schools, get teachers into schools, help ministries of health provide basic services, and help ensure that those services are reaching the most vulnerable. When we build a work force, bring in civil society, stabilize an investment climate, and increase participation in a political process, we are building institutions.

Why is this difficult? There are several reasons. First, our overall engagement outside of our borders has been anywhere from controversial to disastrous. Our lack of active engagement in the region has also put us in a difficult position, as evidenced by the events of the last week. With respect to foreign assistance, we have some specific challenges that I want to outline.

In the 2009 budget request for the region, the President requested a $37 million dollar *decrease* in the core development accounts from what was spent in 2008. More importantly, our government's ability to effectively manage and implement foreign assistance programs has been in decline for decades. As the Chairman of the Foreign Assistance subcommittee, I am working to build up our ability to do this, and I look forward to working closely with Chairman Berman and members of this committee to build us back up not just to where we *used* to be, but to where we *need* to be. USAID's staff is stretched too thin and their programs are getting pulled in too many directions. Without strong leadership and a clear vision, and highly capable staff to *carry-out* that vision, we risk a formulaic application of off-the-shelf ideas. Well, as we all know, in this business, formulas don't always give you the results you expect, and sometimes, ideas were shelved for a reason.

Some have pointed to the increases in remittances and private investment as a justification for decreases in development resources. However, remittances, and private investment are *not* institution-building and they are not a replacement for well-targeted, smart investments in systems of justice, health or education.

In 2004 we saw the arrival of the Millennium Challenge Corporation (MCC). The MCC currently has three Compacts and three Threshold Programs in six countries in the region. The MCC is a good example of the challenge of trying to engage under a different set of rules. It was never meant to replace other assistance. Unfortunately, this has not always been the case. To its credit, the MCC has been successful in attracting the attention and participation of governments. This is positive. It has opened up the process to more local participation and more participation by government officials whose countries have qualified through a more transparent set of indicators. While the actual results are still a few years away—and I intend to study these results carefully—the manner in which the MCC has been able to engage host-country participation is something the development community can learn from. It is by no means the model, but it is one of several models that the U.S. needs to look to as part of our toolkit.

Last year, the Administration proposed what it calls the "Merida Initiative." I travelled to Mexico last fall with Senate Majority Leader Harry Reid and others to explore ways our countries might work better together. The Merida Initiative was one of the topics at hand and I have stayed heavily engaged ever since.

First, I believe a more systematic engagement with Mexico and Central America, in a wide range of areas, is long overdue. I believe some aspects of the Merida Ini-

[2] World Bank Policy Research Working Paper 4487

tiative are a very good start. However, I have tempered expectations that the Merida Initiative is going to result in a measurable reduction in the drugs that enter the U.S.—something that I believe is better addressed by balancing demand and supply reduction. As members of this committee know, the demand for drugs in the U.S. and the supply of weapons from the U.S. have fueled illicit activities and violence in the region for a long time, and they're not going to go away in just three years.

In terms of strategy, I believe the institution-building components of the Merida initiative will have the best long-term benefits. I question whether or not we have struck the right balance between long-term institution-building and short-term military interventions. I understand the justification for use of the military, but I am concerned about human rights, and I am concerned about using the military to do the job of the police. I have worked with State Department to get more clarity on the metrics for success. In other words, after 3 years, what measurements are we going to use to know if this investment was worthwhile. We have made some progress, but this is going to require constant attention.

So, how can we do this better? First of all, governments can't do this alone. We need to continue to expand the people with whom we coordinate—both in civil society and in the private and philanthropic sectors. We should also think more about regional solutions to regional problems. The hemisphere is brimming with talented people who understand how to build institutions. We need to take better advantage of this talent and broaden our partnerships.

One example of something worth studying is the Balkan Trust for Democracy, which seeks to build civic participation among the grass roots—the nexus between citizens and their government—to strengthen democratic institutions. The Trust is a 10-year, $30 million initiative that seeks to bring together the strengths of the public, private and non-profit sectors for the benefit of people in developing countries. It has received contributions from a wide range of donors including, foundations, governments from the region, and the United States. It is managed in the region by highly capable people from the region.

However, we need to recognize that the more actors that get involved, the more the management and oversight will need to be shared as well. As long as the programs stand-up to rigorous scrutiny and we can show that this is a worthwhile investment for the U.S. taxpayer, we will need to be willing to share both the responsibility and the success—the essence of a true partnership.

One of *my* efforts, along with Senator Martinez, is the *Social Investment and Economic Development for the Americas Act (S.2120)*. This bill has 13 co-sponsors, both Republicans and Democrats, and it was reported favorably out of the Senate Foreign Relations Committee in June of this year. The bill provides $2.5 billion over 10 years for social and economic development in Latin America using both the U.S. Agency for International Development (USAID) and the Inter-American Development Bank. The goals include nurturing public-private partnerships and microenterprise development, reducing the time and cost of starting a business, increasing access to credit, improving the investment climate, strengthening rule of law, and reducing poverty. The approach is to multiply the impact of U.S. investment through the creation of a matching fund for the private sector and member countries of the Bank. The bill requires a 10 percent contribution from the recipient country to allow them to take ownership the projects. Also, the Bill implements a rigorous evaluation and oversight system through impact assessments and an advisory committee to review all projects. This effort will help expand the middle class in the region. This will pay dividends back to the U.S. by creating more customers for U.S. goods, and will provide a foundation for long-term economic and political stability in the hemisphere.

I support efforts to increase our foreign assistance to the hemisphere. However, let me be clear, neither my bill nor additional resources are going to fix everything—foreign assistance has its limits. But, we have not yet approached this limit. More resources, and better-spent resources, combined with active diplomatic and economic engagement will help build the institutions that will create more stable political, social, and economic systems. Only once we recognize that the success of those systems is deeply connected to the success of our own, will we begin to adequately address the joint challenges that threaten our national security, our economy, our way of life. Thank you again for having me here today and I look forward to continuing to work together on these vital issues.

Mr. ENGEL. I don't disagree with a word that you said. I think you have hit the nail right on the head.

One of the things that surprised me the most when I became chairman of this subcommittee was the income disparity you mentioned. I had always known there was income disparity in the Americas. I had really thought that if someone had asked me on which continent there was the greatest income disparity I would have said Africa, and I was shocked when I saw the statistics for Latin America are even more stark and more marked and worse in terms of income disparity than Africa. So I thank you for, you know, pointing that out.

I am going to call on Mr. Burton, because I think he had a question or two. We are not going to keep you. We are just going to——

Mr. BURTON. Mr. Chairman, I don't have a question. I just wanted to comment on the statement made by Senator Menendez.

I think you are absolutely correct. One thing that I hope will be illuminated even more is the security risk, as you mentioned, throughout Central and Latin America. Right now, we just had our Ambassador kicked out of Bolivia. We have got problems like that in some other countries down there. I think Ecuador is one that there is a problem.

Mr. ENGEL. Venezuela.

Mr. BURTON. And Venezuela. I think it is extremely important that we realize, as you have stated—and that is one of the reasons I am cosponsoring your legislation—that we realize that this is really a defense issue as well as an economic issue. If Central and South America go south—pardon the expression—we are going to have real problems.

This is on our doorstep. We have had terrible problems with immigration, as you know; and as a result of conflict in Central and South America or upheaval, people tend to come to Miami or head north and come through Mexico and across the 2,000 mile border between us and Mexico. So I think it is extremely important.

And one other thing that you did not mention which I hope you will take under consideration is the issue of free trade agreements. I really think that one of the things that we need to help stabilize Central and South America are more free trade agreements to create economic growth and jobs down there.

And one other thing I would like to say—and this is not meant to be overly critical—but I don't think our State Department has paid enough attention to Central and South America over the past several years. This is our front yard, as you have stated; and we need to pay attention to it. And I really thank you very much for your hard work on this.

Mr. ENGEL. And let me just add, and we will let you go, one of the things that I have noticed, no matter where I go in the hemisphere, is the feeling in all of the countries that we have not paid enough attention to them, that we have disengaged from the hemisphere, that our priorities are elsewhere in the world, that we are preoccupied with other things but not in the Western Hemisphere. And if that is the case, we should not be surprised when our adversaries like Iran and China—I am not saying they are necessarily an adversary, but they are certainly competitors—move in and do things and try to get chits with other countries. And, if we don't do it ourselves, we have got no one to blame but ourselves. That is why your bill, the Social Investment and Economic Development for the Americas Act, is so important and is one of the most important things I think that we can pass to help the hemisphere.

So I want to thank you for your work, and I want to thank you for coming here today.

Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman.

Senator, it is good to see you; and, again, I want to commend you for your work.

I would really like to hear your perspective on enlisting the private sector. It is estimated this past year there was about $4 billion worth of assistance that resulted from efforts by U.S. organizations, whether foundations or universities, but various private groups. And also, you know, United States corporations that have invested in Latin America have led the way in the area of corporate social responsibility as well. And with the work that you have invested and looking at how we can more effectively do a better job of directing our foreign assistance, do you have some thoughts about how we can do a better job of enlisting the private sector to be a partner in this process?

Senator MENENDEZ. Well, I appreciate your question, Congressman.

There have been some good initiatives by the private sector. Of course, sometimes the private sector—its initiatives, for example, on human capital, which is good, good for those countries, good for those companies. Institution building, however, is normally not an area where private sector resources flow. And yet in many respects that institution building could provide the biggest dividends to the private sector.

For example, rule of law. A system of justice in which your contract, if you have, you know, the rights on your side both on facts and law, that they can be sustained, not that a system works against you.

You know, we had a Latin American country that took a New Jersey company's investment and just changed the rules of the game on its taxing policy and confiscated $10 million of its assets—clearly, in what is an act that was an unjust taking—and the list goes on.

So I think that one of the things we try to do in the social investment fund, as we have described, is to work to also leverage private sector resources; and that is why we also use the IDB for part of that effort, so that we can have a multiplier effect here. We make the country make an investment, so it is not just a handout. They have got to have a 10 percent investment.

We have a combination where appropriate—depending upon what it is—the development programs that we are pursuing, whether it is USAID or the IDB. And we use the IDB to leverage as well and we look for the private sector investment.

In my written testimony, you will also see the suggestion of something along a fund that was used in Europe and where the private sector was very significantly engaged and run by entities within the hemisphere, owned by entities within the hemisphere, to be able to create other development assistance; and that is—I would commend to your attention that part of the written testimony that talks about that is another option of getting the private sector engaged.

Clearly, as I said, it is not something that the government can do on its own, but there are some institution-building initiatives that the private sector just does not see its investment going to in terms of an immediate return. I would argue that, in many cases, they have long-term returns that would be very significant; and if we could entice them to, it would be great.

Mr. ENGEL. So, Senator, we are going to let that be the last word. Because, through the wonderful world of BlackBerrys, your staff has just informed my staff that you have a vote. So we are going to let you go.

Thank you so much for coming and welcome back. Thank you.

Okay, we will now proceed with opening statements; and let me say that I want to reiterate what I said earlier in commending the leadership role that Chairman Berman has taken in announcing his intent to rewrite the Foreign Assistance Act. Today's hearing marks the beginning of my work to support our chairman in ensuring that we adequately and effectively provide foreign aid to our friends in the Americas.

I would venture to say that no member of this subcommittee would disagree with me that we need to significantly increase foreign aid to our neighbors in Latin America and the Caribbean. Quite frankly, budgets show priorities, and when foreign aid to the hemisphere lags behind, our allies understand the message that is being sent to them, and it is not a good one. That is why the Social Investment and Economic Development Act for the Americas of 2007, as I mentioned before, introduced by Senators Menendez and Martinez in the Senate and by myself and Congressman Burton in the House is so important both substantively and symbolically. I urge my colleagues in both Chambers to quickly pass this bill, and I also urge the appropriators to ensure that this new assistance is appropriated.

I would now like to very briefly comment on four key areas where I believe we must make improvements in our foreign aid strategy in the hemisphere.

First, when thinking about foreign aid in the Americas, it is critical that we not overlook some of the larger countries with higher GDP. Brazil, of course, is a key example. Brazil is the 11th largest economy in the world, the largest in Latin America and one of the largest in the developing world. Yet it is also home to 50 percent of the population in Latin America defined as poor—50 percent—and there are 35 million people living in extreme poverty in Brazil's north and northeast.

Aid to Brazil, unfortunately, has been shrinking in recent years. We need to find ways to increase development aid to crucial allies like Brazil and Mexico with high levels of GDP but also large products of poverty; and, of course, this subcommittee had a codel to Brazil, where we studied things that I just mentioned.

Secondly, remittances significantly dwarf U.S. foreign assistance in the hemisphere. Latin America and Caribbean workers sent home a record $65½ billion of remittances last year. That is more than the combined total of foreign direct investment and official development assistance flowing to the region. I believe the U.S. can do much more to help families and communities in the Americas leverage remittances for development. First and foremost, this means that USAID, the Millennium Challenge Corporation and the Inter-American Foundation should play a greater role in helping remittance senders and recipients enter the financial mainstream. We had hearings in this subcommittee about remittances; and I believe, as I said then and say now, that we ought to be able to work something out with the banks to make this process more efficient.

Thirdly, several countries in Latin America have refused to sign so-called Article 98 agreements which make U.S. Government personnel immune from the International Criminal Court's jurisdiction. As a result, certain foreign aid for these countries has been held up. Secretary of State Condoleezza Rice once said that with these restrictions, and I quote her, "we are cutting off our nose to spite our face." I have introduced legislation to remove Article 98 restrictions on foreign aid. I believe that we must eliminate this failed policy once and for all.

Fourth, we must consider a more aggressive campaign to help countries completely dependent on oil imports to develop clean domestic energy resources. Why? Today, most Caribbean and Central American nations are almost entirely reliant on oil provided by Hugo Chavez's Venezuelan Petro Caribe program. With oil selling at $100 a barrel—thankfully, it is less these days—if I were the President of one of those countries, I would probably take the deal, too. But I would know that I would be under Chavez's thumb for the foreseeable future. Who wants that? By aggressively helping these countries escape their oil dependence and Chavez problem, we would actually be helping ourselves. These nations would be more independent in their foreign policy, as Mr. Burton mentioned, and more able to focus their limited resources to lift up their poor and promote regional prosperity.

There is obviously much more to cover, but I will leave things here and hope we can discuss these subjects and others in greater depth in the question and answer portion of today's hearing.

[The prepared statement of Mr. Engel follows:]

PREPARED STATEMENT OF THE HONORABLE ELIOT L. ENGEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, AND CHAIRMAN, SUBCOMMITTEE ON THE WESTERN HEMISPHERE

I am pleased to welcome you to today's hearing on Foreign Assistance in the Americas. I commend the leadership role that Chairman Berman has taken in announcing his intent to rewrite the Foreign Assistance Act (FAA). Today's hearing marks the beginning of my work to support our Chairman in ensuring that we adequately and effectively provide foreign aid to our friends in the Americas.

I would venture to say that no Member of this Subcommittee would disagree with me that we need to significantly increase foreign aid to our neighbors in Latin America and the Caribbean. Quite frankly, budgets show priorities and when foreign aid to the hemisphere lags behind, our allies understand the message that is being sent to them. That is why the Social Investment and Economic Development Act for the Americas of 2007, introduced by Senators Menendez and Martinez in the Senate and by myself and Congressman Burton in the House, is so important both substantively and symbolically. I urge my colleagues in both chambers to quickly pass this bill, and I also urge the appropriators to ensure that this new assistance is appropriated.

I now would like to briefly comment on **4 key areas** where I believe we must make improvements in our foreign aid strategy in the hemisphere.

First, when thinking about foreign aid in the Americas, it is critical that we not overlook some of the larger countries with higher GDP. Brazil, of course, is a key example. Brazil is the 11th largest economy in the world, the largest in Latin America and one of the largest in the developing world. Yet, it is also home to 50% of the people in Latin America defined as poor, and there are 35 million people living in extreme poverty in Brazil's North and Northeast. Aid to Brazil unfortunately has been shrinking in recent years. We need to find ways to increase development aid to crucial allies like Brazil and Mexico with high levels of GDP, but large pockets of poverty.

Second, remittances significantly dwarf US foreign assistance to the hemisphere. Latin American and Caribbean workers sent home a record $66.5 billion of remittances last year. That's more than the combined total of foreign direct investment and official development assistance flowing to the region. I believe the US can do much more to help families and communities in the Americas leverage remittances for development. First and foremost, this means that USAID, the Millennium Challenge Corporation (MCC) and the Inter-American Foundation should play a greater role in helping remittance senders and recipients enter the financial mainstream.

Third, several countries in Latin America have refused to sign so-called Article 98 agreements which make US government personnel immune from the International Criminal Court's (ICC) jurisdiction. As a result, certain foreign aid for these countries has been held up. Secretary of State Condoleezza Rice once said that with these restrictions, we are "cutting off our nose, to spite our face." I have introduced legislation to remove Article 98 restrictions on foreign aid. I believe that we must eliminate this failed policy once and for all.

Fourth, we must consider a more aggressive campaign to help countries completely dependent on oil imports to develop clean domestic energy resources. Why? Today, most Caribbean and Central American nations are almost entirely reliant on oil provided by Hugo Chavez's Venezuelan Petro Caribe program. With oil selling at $100 per barrel, if I were the President of one of these countries, I'd probably take the deal, too—but I'd know that I would be under Chavez's thumb for the foreseeable future. By aggressively helping these countries escape their oil dependence and Chavez problem, we'd actually be helping ourselves. These nations would be more independent in their foreign policy and more able to focus their limited resources to lift up their poor and promote regional prosperity.

There is obviously much more to cover, but I will leave things here and hope we can discuss these subjects and others in greater depth during the question and answer portion of today's hearing.

I am now pleased to call on Ranking Member Burton for his opening statement.

Mr. ENGEL. I am now pleased to call on Ranking Member Burton for his opening statement.

Mr. BURTON. Mr. Chairman, I don't have an opening statement. I think the issue has been covered very well.

The only thing that I would like to ad to what has been said is that we take particular interest in foreign policy issues around the world, and it is important that we do that. But it seems to me that we have been neglecting a lot of things that should be done in Central and South America; and, as a result, I think we reap the whirlwind. So I would like to see us pay a lot more attention—our State Department pay a lot more attention to Central and South America because of the reasons that I mentioned when Senator Menendez was here.

With that, I would yield the floor; and I would like to have my entire statement in the record.

Mr. ENGEL. Thank you. Without objection, so ordered.

[The prepared statement of Mr. Burton follows:]

PREPARED STATEMENT OF THE HONORABLE DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

To begin, I would like to thank the Chairman for holding today's hearing to discuss how we can better leverage American taxpayer dollars to provide more effective and timely assistance to our allies around the world. We owe it to the people who are receiving our funds to ensure that the money we're sending actually benefits them; and I strongly believe that we owe it to the hard working people of this country to ensure that their taxpayer dollars are being spent wisely.

The current foreign assistance structure in the United States is, I believe, by and large a legacy of our Cold War era policies which do not reflect the current international environment. As we have heard in previous hearings that have touched on this topic, we currently have 26 separate and distinct Federal agencies and offices involved in disbursing our foreign assistance funds; with the Department of State and USAID controlling just over half of the assistance, and projected to spend roughly $24 billion in assistance to 155 countries in 2008. It's never an efficient use of taxpayer dollars to have 26 different bureaucratic agencies trying to do the same job and it is especially inefficient when the agencies do not coordinate their efforts to ensure they are not working at cross purposes to one another.

How best to reform this byzantine structure is still open to debate. The critical question we need to answer first though is what compelling interest are we trying to pursue internationally and how can our foreign aid promote this interest. By that I mean, are we using foreign aid to develop national security alliances as we did during the Cold War; or should our aid be focused on lifting nations out of poverty, or promoting democracy, or combating global environmental challenges; the list could go on and on. Fortunately, even with this potentially hazardous clash of opinions on motivating factors, I believe there is one area of growing consensus; namely that the most effective aid programs are not those run by government bureaucrats but those run by private donors utilizing local initiative and involvement.

Our witnesses today are hopefully going to talk a bit about how these types of private donor aid programs have been very successful throughout Latin America. If foreign direct investment and micro lending through private organizations does work more effectively than current U.S. Government programs, then perhaps our panelists might offer some suggestions about how we can utilize these concepts to modify our current ineffective programs. The Millennium Challenge Account is a result of this change in thinking regarding our foreign aid, is it paying off? What have we learned from this new approach? I think we also need to talk about whether long term initiatives like trade agreements work better to further U.S. interests as compared with cash-based aid programs. Finally, as many of you know, I have long supported the Social Investment and Economic Development Act for the Americas along with my colleague, Chairman Engel; and I would like to hear our witnesses comment, if possible, on whether we got this bill right; can it do what we need to do in terms of providing assistance to Latin America?

With these important questions before us, I'd like to thank our distinguished panelists for being here today, and I look forward to hearing from you on this timely topic.

Mr. ENGEL. I agree with everything Senator Menendez said; and, Mr. Burton, I agree with everything that you have just said.

Are there any other members that would like to make a brief opening statement?

Mr. PAYNE. Mr. Chairman, let me commend you for calling this very important hearing. Having been a member of this committee for 20 years, I, too, feel that in my opinion there has not been enough attention paid to our colleagues to the south. I do believe that there is much more we can do.

I think that this title of Foreign Assistance in the Americas is very appropriate; and the areas in which the legislation that you have introduced to reduce poverty and expand the middle class, foster increase in economic opportunity are so important.

Also, I think it is a poor example when we do not pay our dues, so to speak, in the $51 million that we are behind in the Inter-American Development Bank. The arrears certainly doesn't send a strong message when we are trying to win over the hearts and minds of Latin Americans and Caribbean people and we criticize those who are aggressively doing things like Chavez and others but then we fail to act in a very positive and aggressive way.

So I think that some of the problems that we are seeing is our lack of initiative, and I hope with your leadership that we will be able to change.

And, finally, I continually have concerns about the approximately 150 million people of African descent that live in Latin America and the Caribbean, certainly the largest population of African descent people outside of Africa. And if we go country to country, we will find that the Latin Americans of African descent fall down into the lowest economic barriers in every single country in Latin America.

So I hope that our legislation as we move forward, we would also keep that as one of our goals, to try to have that tide that lifts all ships and hopefully that we could even get the Afro Colombians' and Afro Latinos' ships to rise as we have stronger economic programs.

So, with that, I yield back the balance of my time.

Mr. ENGEL. Mr. Payne, before I call on Mr. Sires, I just wanted to comment on something that you just said about people of African descent in Latin America. One of the shocking statistics—because it isn't something you really think of when you look at the countries of the world—the country with the greatest population of people of African descent is I believe Nigeria and the second country is Brazil. So what you said is right on the money.

Mr. Sires.

Mr. SIRES. Thank you, Mr. Chairman; and thank you again for holding this important discussion.

I always continue to be frustrated by the lack of substantive aid that is provided to the Caribbean and Latin America, and it is my view that until we are able to help them bring their standard of living, we still are going to have an immigration problem. We have to try to help them as much as we can in their own country, and I think this is a beginning. I think this is a right step and thank you for holding this hearing.

Mr. ENGEL. Thank you very much.

Mr. Weller, I will give you the opportunity if you would like to. If not, we will call on the witnesses.

Okay. Thank you.

I am now pleased to introduce our distinguished private witnesses, and I would ask them to please take their seats. I hope the names are reflected on your sides as well as ours. I guess they are, because you sat at the right places.

Welcome and thank you. I look forward to hearing your testimony.

Mark Schneider is senior vice president and special adviser on Latin America at the International Crisis Group. He previously served as director of the Peace Corps and as assistant administrator for Latin America and the Caribbean at the U.S. Agency for International Development affectionately known as USAID.

Nancy Birdsall is president at the Center for Global Development (CGD). I hope they don't test me on all these letters and all these nicknames. She is a former executive vice president at the Inter-American Development Bank.

And last, but certainly not least, Eric Werker is an assistant professor at Harvard Business School. He previously worked as an economist at the Millennium Challenge Corporation. We are going to have some letters for that, MCC.

So welcome to all three of our distinguished witnesses. I will put all of your written testimonies into the record in full, and I would ask that you summarize your testimony in 5 minutes or less.

Mr. Schneider.

STATEMENT OF THE HONORABLE MARK SCHNEIDER, SENIOR VICE PRESIDENT, SPECIAL ADVISER ON LATIN AMERICA, INTERNATIONAL CRISIS GROUP, FORMER DIRECTOR OF THE PEACE CORPS, 1999–2001

Mr. SCHNEIDER. Thank you, Mr. Chairman. I want to thank you and the ranking member and the members of the committee for holding this hearing on Foreign Assistance in the Americas and for inviting me to testify.

The International Crisis Group is an independent, nongovernmental organization dedicated to conflict prevention and resolution. In Latin America and the Caribbean, we focused on the Andean countries, Haiti and on the costs and violence of drug trafficking.

I think it is important, as others have said, to recognize that we meet today with clouds casting really disturbing shadows over inter-American relations. Ties with Venezuela and Bolivia clearly have sunk to all-time lows. I cannot recall any time where a United States Ambassador, particularly a distinguished career Ambassador, has been expelled from one country in this region, let alone two. We have had the region once more pushed into a United States-Russia confrontation by Venezuela's invitation to Russian bombers and warships.

Finally, today we know that Bolivia is facing the possibility of severe civil conflict. In the last few days, between 20 and 30 people are reported to have died in anti-government protests; and, thus far, internal and external mediation has not succeeded. Yesterday, hopefully, the resolution that was adopted unanimously by heads of state of South American countries in Santiago will lead to the kind of mediation that will bring an end to the conflict in Bolivia.

At the same time, we have to look at the Caribbean and recognize that particularly Haiti has been virtually devastated by four hurricanes in the space of a month; and it really has undermined the capacity of that country to move out of the fragile-state status that it has been in for so long.

The U.N. has called for an emergency level of $100 million in relief. That is just immediate relief. However, to repair, rebuild the economic infrastructure, replace the harvest, do everything else to return the country even to where it was before, I have heard estimates—and I think they are probably accurate—that it will be a cost of $1 billion.

What is needed right now—and here is where United States leadership can play an immediate role—and that is for a Haitian international community task force to begin now on planning the same kind of post-hurricane reconstruction effort that was done after Hurricane Mitch in Central America, where together the IDB, USAID and others put together a conference that essentially began immediately on reconstruction. That needs to be done in Haiti and ideally for the other Caribbean hard-hit countries as well.

Let me move from there, if I could, to the broad kinds of challenges facing the region which have to be dealt with in revised foreign assistance.

First, obviously, are threats to democracy from corruption and the absence of the rule of law. We have seen the end, hopefully forever, of the era of military dictatorships in the region. However, we also know that democratic partners are the best guarantors of advancing our own values and our own interests. However, democracy and stability are under threat in several countries, Venezuela particularly, but also Bolivia; and, Congressman Burton, you have also mentioned others as well.

To some degree, both Venezuela and Bolivia result from the failure of governance. In Venezuela, too much corruption opened the door to the populist appeal of this former coup leader. In Bolivia, almost 500 years of exclusion and discrimination barred the indigenous majority from meaningful participation in public life.

Polls over recent years have shown that 68 percent of Latin Americans believe their public officials are corrupt; 66 percent have little or no confidence in their judicial system. The right response and our foreign aid can play a role here. Not to do everything, but to play a role; and that is to work with others, including the U.N., the IDB and the OAS, which is specifically charged with monitoring the observation of the Inter-American Democratic Charter, to try and move to strengthen the institutions of democracy, particularly the rule of law.

Here it seems to me that we have to go beyond what we have done before. Not only what the U.S. does, but we have to bring the World Bank and the Inter-American Development Bank into the efforts specifically with respect to helping countries build criminal justice systems. Right now, we don't get their support on helping countries on police reform, on prison reform or on the criminal justice side of the judiciary. We need to have them engaged in this process as well.

The second challenge, as we heard from Senator Menendez, is reducing the continuing high levels of inequity and exclusion. Mr. Chairman, you have mentioned that as well.

Today, even though there has been growth of about 5 percent for the last 5 years, there are still 190 million people in the region living on less than $2 a day. There are almost 70 million people living on less than $1 a day. That is more than the number of people in that situation in 1980 when they were living under military dictatorships. Today, we mostly have democratic systems, but there is going to be a huge, unfortunate response if those governments can't respond to those issues.

Let me add one point in terms of inequity. You heard the overall figures from Senator Menendez. In Bolivia, instead of the difference being 30 times the difference between the top 20 percent and the bottom 20 percent, in Bolivia, if you take the top 10 percent and the bottom 10 percent, it is a 90 times difference. The top 10 percent capture 70 percent of the national income in Bolivia.

Now, the response has to be, we would argue, in at least three areas where we can do things. One is expanding help for rural development and small farmers, two is expanding quality education, and three is encouraging tax reform. Otherwise, the governments don't have the resources to deal with those issues of strengthening institutions.

Just to give you an idea, this year the administration has asked for $2 billion for the hemisphere in military and economic assistance. Of that total, only $47 million is for agriculture. For all three areas, education, agriculture and public administration reform, the request is for less than $100 million. That is simply not enough.

Now I would argue that what we have to look for in addition is this being a joint effort with the rest of the institutions that deal with foreign assistance in the hemisphere, including the IDB and the World Bank.

A third challenge involves crime and drugs. We haven't talked a lot about that today, but that is fundamental. It challenges institutions. It challenges development. What we see throughout the region is the increasing threat of drug trafficking to countries, not only the source countries, Bolivia, Ecuador, Peru and Colombia, but the transit countries and now Mexico particularly. I just want to emphasize——

Mr. ENGEL. I am going to have to ask you to sum up.

Mr. SCHNEIDER. Very quickly, Colombia has not succeeded in reducing the area under cultivation and the amount of cocaine coming into the United States. I would hope that the foreign assistance reform would look at what can be done differently and better to do that.

And, finally, if you go back to the question that you have raised about what is wrong with the way we are structured, USAID is now under 3,000 employees. It was 15,000 in the 1960s. Right now, we have 20 different government agencies managing foreign assistance. That just can't work. We have got to come back to a system in which there is a single development agency, ideally at the Cabinet level, that deals with development, humanitarian action and conflict prevention.

Thank you.

Mr. ENGEL. Thank you. I am sure we will bring out some of these points and questions.

[The prepared statement of Mr. Schneider follows:]

PREPARED STATEMENT OF THE HONORABLE MARK SCHNEIDER, SENIOR VICE PRESIDENT, SPECIAL ADVISER ON LATIN AMERICA, INTERNATIONAL CRISIS GROUP, FORMER DIRECTOR OF THE PEACE CORPS, 1999–2001

I want to thank the Chairman of the Foreign Affairs Committee, Rep. Howard L. Berman, the Chairman of the Subcommittee on the Western Hemisphere, Rep. Eliot L. Engel, and the ranking members, Rep. Ileana Ros-Lehtinen and Rep. Dan Burton for the invitation to offer testimony this afternoon on "Foreign Assistance in the Americas".

We meet today on this subject at a disturbing moment.

- In the past week we have seen two distinguished U.S. career ambassadors expelled from Bolivia and Venezuela. The U.S. responded in kind with respect to the Bolivian Ambassador to the U.S. and Venezuela already had recalled its Ambassador.
- The Treasury Department then designated two Venezuelan intelligence officers and the former Minister of Interior as cooperating with the FARC guerrillas in Colombia in their drug-trafficking.
- Russia has sent strategic bombers, escorted across the Atlantic by NATO fighters, to Venezuela, and four Russian naval ships are expected sometime in November.

- Finally, Bolivia's president has ordered martial law in one department and clashes with protestors reportedly have cost the lives of some 20 to 30 persons. Internal and external mediation efforts have yet to produce a durable solution.

Hopefully these dark clouds will pass quickly and the countries of the region can return to the fundamental development challenges still facing the hemisphere—where U.S. foreign policy and foreign assistance can play a positive role.

- The Caribbean also has endured real storms. Four hurricanes have lashed Haiti in two months and that impoverished country's chances to move beyond its fragility have become slimmer. The UN has put out an emergency call for $100 million in immediate life-saving relief aid but to repair, rebuild and refurbish the economic infrastructure, schools, health clinics, make up for the lost harvests, replace irrigation systems and farm to market roads, a massive recovery and reconstruction plan is required and likely to cost closer to $1 billion. A joint Haitian-international community task force should be working as soon as the waters recede to prepare the same post hurricane donors conference that followed Hurricane Mitch in Central America—and ideally should provide support for other hard-hit Caribbean countries as well.

The Committee promises a rewrite of the Foreign Assistance Act and the reform of U.S. foreign assistance. I commend the Committee for initiating these hearings to jump-start the planned reform of U.S. foreign assistance. I would like to comment first on the critical threats facing the region where U.S. foreign aid can help and then on the lessons learned with respect to U.S. foreign aid in the region—some of which already have been incorporated into the Social Investment and Economic Development Fund legislation.

I went to Latin America first as a Peace Corps Volunteer in 1966 in El Salvador and worked on community infrastructure and social needs in an urban barrio for the anti-poverty office of then San Salvador Mayor Napoleon Duarte. It was a military-run country where multi-party elections were still only permitted at the local level. I saw poverty, repression and the courage of the people of that nation up close. In one way or another that experience has guided me as I have had the privilege of pursuing those issues as Congressional staff, at State, PAHO, USAID, Peace Corps and now the Crisis Group.

Among the broad challenges facing the countries of the region:

Threats to democracy: corruption and gaps in the rule of law: We have seen the end—hopefully forever—of the era of military dictatorships, some of which this country supported in reacting to the Cold War. Democratic partners are the best guarantors to advance our values, our interests and our security. Yet democracy and stability are under threat in a few countries, Venezuela particularly, but also Bolivia, even if the histories of how they have gotten to this point are very different.

To some degree, both result from the failures of governance. In Venezuela, too much corruption opened the door to the populist appeal of a former coup leader to win elections. In Bolivia, almost 500 years of exclusion and discrimination barred its indigenous majority from meaningful participation in national life.

In Latin America and the Caribbean, in the past decade, we have seen 14 elected Presidents who did not finish their term of office, some removed with only minimal legal trimmings. Key elements of democracy involving pluralism, checks and balances and separation of powers are no longer assumed essential in some countries. And political parties are failing the task of representation in too many countries.

We have not paid sufficient attention to issues of governance in our foreign assistance, in strengthening public administration, independent mechanisms of anti-corruption and the civil society organizations whose fundamental objective is to promote greater transparency in government. We need to do more bilaterally as well as with institutions like the IDB, the UN, the World Bank and the OAS, the latter specifically charged with the monitoring observation of the Inter-American Democratic Charter.

Despite the adoption of the Inter-American Convention Against Corruption in 1996 and follow-up mechanisms, in 2005, the Latinobarómetro, a hemisphere-wide poll, found that more than 68 percent of respondents believed that their public officials were corrupt, ranging from 41 percent in Uruguay to 82 percent in Ecuador.[1]

Related to the issue of corruption is the sense of impunity that convinces many in the region that the elites in their countries fail to pay their taxes, fail to treat

[1] Corporación Latinobarómetro. *Informe Latinobarometro 2005: Diez años de opinión pública, 176.554 entrevistas, 10 mediciones en 18 países.* Santiago, Chile. 2005; p.28.

their employees with dignity, receive favored access to contracts and pay their way out of any brush with the law. The belief that those with power have impunity from the fair enforcement of the law undercuts the democratic ethos. It violates the social contract. A few years ago, a poll found that 66 percent of Latin Americans stated that they had little to no confidence in their judicial system.[2]

Response: Strengthening the rule of law has to be a high priority concern of anyone interested in political stability, in sustaining economic reform policies and in strengthening social cohesion. It also is critical to addressing underlying causes of conflict in many of the countries of the region. There is a need for more competent police, an impartial judiciary and access to justice for the poor.

We have not been well organized to provide that kind of integrated assistance in countries before conflict occurs and even less able in the aftermath of conflict. Nor have we managed to bring the IFI's on board fully when it comes to helping countries invest in police, in criminal justice reform or in prison construction and correction services. Democracy, stability and economic development require a functioning, fair and independent criminal justice system.

A second challenge is to expand growth and reduce continuing high levels of Inequity and Exclusion:

The economies in the region have shown steady growth, averaging 5.3% since 2003, far below Asia's 9%. (GDP per capita is still down around 3%.) The *Economic Survey of Latin America and the Caribbean 2007–2008*, released in August by the Economic Commission on Latin America and the Caribbean (ECLAC) shows growth dropping to 4.7% this year, and 4.0% next year. Of the 20 countries surveyed, 16 show declining growth and eight see their GDP drop 2% to 4% since 2007.

Poverty rates still are over 36% and extreme poverty is just below 15%, according to ECLCA, better than 5 years ago but still not good. Those numbers translate to 194 million people living on less than $2/day and 69 million living on less than $1/day. That means that under democracies today, more people are living in poverty and extreme poverty than under military regimes in 1980. Part of the reason for some of the earlier drop in poverty rates were income transfers from relatives in the U.S.-remittances estimated by the IDB at $45 billion in 2007. But this year, 25% fewer individuals are planning to send money this year as a result of U.S. economic woes.

On the equity side, we can see virtually no change with respect to income disparity. Latin America remains the most unequal region of the developing world. The CIA World Book has 11 of the 18 worst countries in income inequality measured by the Gini coefficient coming from Latin America. UNDP and CEPAL report that the top 10 percent on average capture 48% of national income, the bottom 10 percent 1.6%. Recalling Bolivia, the richest 10% receive 70% of that country's income and the bottom 40% share barely 10% of national income.

A linked phenomenon to the challenge of reducing poverty and inequity is the growing realization that indigenous peoples and Afro-Latin-Americans still are discriminated against on a daily basis. The World Bank study found indigenous men earning 65 percent less than white in seven countries with the highest numbers of indigenous among its population. Indigenous women also have the least access to potable water, education and employment in the hemisphere.

Response: There are three areas of action where foreign aid reform in the region can make a major attack on inequity and exclusion; expanding help for rural development and small farmers, expanding quality education and encouraging tax reform. Support for these activities in the FY2009 budget request of $2 billion in military and economic aid for the region was less than $100 million.

It is in the rural areas where there can be the greatest direct impact on both growth and poverty reduction through investing in physical infrastructure, income generating opportunities, and social services. The World Bank Development report on agriculture this past year and the earlier "Beyond the City" report spotlighted the drag of rural poverty on national economies. With food prices rising, the benefit of stimulating food production among poor rural farms is self-evident.

Yet in the FY2009 U.S. foreign assistance request, the amount sought for support of agriculture in the region was only $47 million, apart from alternative development funding in four countries. That failure goes back through several administrations in terms of the tendency to disregard the importance of reducing rural poverty and supporting small farmer agriculture.

Much is known on how foreign assistance can help address rural poverty reduction and small farmer agricultural production:

[2] Ibid, p. 24.

- Support ways to expand access of the rural poor to land through land markets, land funds and what Brazil calls "land market-assisted land reform", through expropriation of unproductive land, or through a land tax mechanism that encourages making more land available to small farmers;
- Help provide secure title to the land that the poor own enabling them to acquire working capital for their farming and micro and small loans for off-farm activities;
- Invest substantially more in micro and small credit facilities. In 1999, USAID was financing credit for close to 1 million microentrepreneurs and the IDB, World Bank and others another 1 million—and the need was for 50 million;
- Invest in human capital formation—in schools, health, nutrition—and in social capital; cooperatives and joint ventures, small and medium businesses to create formal sector employment and increase funding for labor rights enforcement;
- Invest in technology and rural infrastructure—so that rural roads, electricity, water and sewers and information technology actually reach the rural poor.

In the 1930's, this country, as part of the "New Deal" made a massive investment in rural infrastructure. The same needs to happen in Latin America.

The next Summit of the Americas should launch a Rural Development Task Force of the Americas partnering USAID with other bilateral aid organizations such as CIDA and the EU but even more important with the Inter-American Foundation, UN International Fund for Development, IICA, the IDB and the World Bank to finance a major assault on rural poverty. Part of that investment could expand significantly the resources available in the Social Investment and Economic Development Fund.

Let me also just add arguments as to why these actions are in the U.S. national interest. The flow of illegal migration from Central America and Mexico originates in the poorest rural communities of those countries. Coca cultivation takes place in the poorest regions of the Andean ridge countries. Those are the same regions where the FARC and the illegal armed groups have found a home in the past—and today. They also are the regions where the indigenous reside.

Two final suggestions for foreign aid to help reduce inequity and exclusion. The first is access to quality education. In the $2 billion budget request for FY2009, $48.7 million was proposed for education. Yet, education—especially girls' education—remains one of the most cost effective investments in human capital and in the future of the region. We need to do more.

The second is ensuring that there are adequate tax revenues available to the state to actually fund some of these needs and to do it in a way that promotes greater equity. As an example, despite all of the commitments that have been made over time, in Guatemala, tax revenues still represent barely 10% of GDP and not surprisingly the capacity of the state to offer education, health, or reach the rural population with basic infrastructure is limited. Tax administration and tax reform have not been among U.S. foreign assistance priorities in recent years.

A third challenge to development involves crime and drugs: Mexico has sent 25,000 military troops and federal police to its northern border and other centers of drug trafficking to fight the well-armed cartels. This year the pace of drug-related killings could produce a 50% increase over the 2,500 deaths recorded last year. The threat to Mexican states is very real as its territory has become the jumping off point to carry the bulk of Colombian cocaine into the U.S.

Plan Colombia has helped strengthen the capacity of the Colombian state to defend itself against the FARC and the ELN, to reduce the presence of paramilitary forces and to extend the presence of the state, but the counterdrug objectives have not been achieved. Coca cultivation remains as high today in Colombia as at the start of Plan Colombia. As much or more cocaine is being produced in the Andean ridge countries and is being transported to the U.S., to Europe and to increasing consumer markets in Latin American countries as well. In the process, transit countries are targets of corruption and violence.

Last Thursday, the White House Office of National Drug Control Policy (ONDCP) reported 2007 production of coca leaf in Colombia had skied to 167,000 hectares, which together with Peru and Bolivia, take the Andean Ridge total to more than 230,000 hectares, a 20-year high. Colombian coca cultivation, according to U.S. government estimates, has risen every one of the past four years (113,850 hectares in 2003, 114,100 in 2004, 144,000 in 2005, 157,200 in 2006 and 167,000 hectares in 2007).

Colombia remains the producer of about 90% of the cocaine coming into the U.S. and total cocaine coming out of the Andes to all markets remains at least 1000 metric tons. ONDCP director John Walters and other U.S. officials stated six months ago that total cocaine trafficked out of the region last year rose to some 1400 metric tons. Last week, ONDCP announced that it is calculating differently the estimated cocaine production in Colombia so that cocaine production, despite the high cultivation mark, was estimated at 535 metric tons in Colombia in 2007. While that lower figure is disputed by other parts of the U.S. government, it still represents 100 metric tons of cocaine higher in Colombia than in 2004. And the region as a whole was estimated to produce more cocaine than in 2001.

One other thing to note is that the Colombia drug flow remains in the hands of the FARC, of some un-demobilized paramilitary, of new illegal armed groups and of "pure" drug traffickers. There were 12 departments where coca was grown in 1999 and after the hugely expanded spraying effort, coca is cultivated today in 23 of 34 departments.

The wholesale value just of the 535–600 metric tons coming out of Colombia is an estimated $12 billion. When it gets to the 38 hub metropolitan areas in the U.S. now primarily through the Mexican cartels who now control U.S. distribution, the value reaches an estimated $60 to $90 billion.

Response: There needs to be fundamental modifications in the counter-drug strategy to do a better job of reducing the production and trafficking of cocaine into the U.S. and the continued threat of an organized criminal network that reaches from the Andes to corrupt government officials across the Caribbean and Central America, producing near wartime conflict along our southern border. This past spring Crisis Group published two reports, the first defining the extent of the threat and the second offering clear recommendations for change. *Latin American Drugs I: Losing the Fight*, Latin America Report N©25, 14 March 2008 .*Latin American Drugs II: Improving Policy and Reducing Harm*, Latin America Report N©26, 14 March 2008

Current policies with respect to demand reduction are not working, a dangerous development since so long as there is steady demand for cocaine, somehow, somewhere, ways will be found to satisfy that demand. In source countries for coca cultivation and cocaine production, and transit countries, institutions will be tainted with corruption and lives will be lost.

The primary actions taken domestically by the U.S. to reduce demand are incarceration of users and traffickers, criminal law enforcement and interdiction that add up to over $20 billion. Education, prevention and treatment programs are barely 25% of that total.

There should be a fundamental shift away from a one-size-fits-all approach to criminal incarceration, whether they are recreational users, chronic users, old/young or traffickers. The U.S. looks at the problem of demand reduction largely as a crime problem. If chronic users were seen through a public health prism, and traffickers as criminals, there would be a far different and we believe more effective policy and perhaps also do a better law enforcement job in breaking the traffickers. We believe that there has to be a high level review by the next Administration and Congress with a hoped for end being far greater priority and greater resources to:

- expand drug education and prevention programs at high schools and develop high impact programs targeting cocaine users.
- increase the number of drug courts, which provide non-penal sanctions for users and seek to induce treatment but there are only 2000 nationally and there are 1.6 million drug-related arrests.
- establish more in-prison and transition programs for drug detainee users, juvenile referral facilities and community-based follow-up programs.
- engage European and other authorities more on drug prevention, treatment, rehabilitation and law enforcement.
- make using cocaine as a recreational drug unacceptable, as stigmatized as driving when drinking or smoking. There must be a dedicated effort to bring role models into the fight against cocaine because its effects in Latin America, in the streets of the US and increasingly in Europe as well.

Nor are policies on supply reduction working. Here the reports find that an eradication first strategy that pays for helicopters and small planes to spray chemicals on coca plants has not produced net reduction in cultivation. It also has serious negative consequences. It alienates communities and farmers, those who grow coca and those who do not—from the government of Colombia and the government of the U.S. Too often, it kills food crops next to the coca plants, and coffee plants over the coca plants. While the long-term health consequences are in dispute, the issue is used politically against both Colombia and the U.S.

We urge a refocus on supply reduction efforts by:

- increasing massively the alternative and rural investment in infrastructure and governance, institution-strengthening, and economic options under Plan Colombia and the Andean Counter-Drug Initiative (ACI)—and by the countries themselves. The U.S. Congress began that process in the FY2008 appropriation bill;
- changing the Colombia coca crop eradication use of aerial spraying to a last resort with manual eradication tied to immediately available economic incentives for farmers and emphasizing much more, community-based eradication, as in Peru;
- reinstating Drug Enforcement Administration (DEA) helicopter interdiction operations in Haiti based on the successful 2007 pilot operation;
- focusing more interdiction efforts closer to, and on, U.S. borders, particularly the Mexican, where the loss of cocaine is costlier and not as easily replaced by traffickers as in the source countries;
- establishing stronger cooperation and information exchange with EU and Latin American law enforcement/counter-drug agencies to improve interdiction and the dismantling trafficking organizations;
- increasing the focus of the Mérida Initiative on strengthening institutional and law enforcement capabilities in Mexico and Central America, with a priority on addressing corruption.

A fourth challenge is to manage foreign aid resources more effectively, drawing on a variety of lessons.

- **First, there has to be ownership by the country rather than the donor and by the communities which ultimately are program beneficiaries.** Programs that are built with the full range of society, business, NGO's civil society and government, deciding on goals and strategy then foreign assistance are more likely to succeed. The Social Investment and Economic Development Fund, introduced initially by Senator Menendez when he served in this body, and now with a bi-partisan list of sponsors in both Senate and House, led here by you Mr. Chairman and your ranking minority member, Mr. Burton, has that characteristic.
- **Second, we can't do very much alone.** There are a whole range of other donors, bilateral and multilateral, and we need to develop shared plans to help countries carry out their development strategy. We also need, particularly in this region, to allow more funds to go through the budgets of other countries—but then to hold them accountable.
- **Third, we need to make our aid programs more predictable** and that means longer term commitments, like the 10-year commitment built into the Social Investment and Economic Development Fund. A similar 10-year period to use **conditional cash transfers** to poor families where the only condition is that the children go to school and vaccinated might be pursued with the IDB and World. We have seen those bank-supported programs work in Brazil with *Bolsa Familia, Oportunidades* in Mexico, *Path* in Jamaica and *Families in Action* in Colombia. If economic growth slows, revenues decline, and the cash transfer programs are cut, expect devastating social and political consequences.
- **Fourth, we should eliminate tied aid** because of its high cost and because it means less efficient use of aid for poverty reduction and long-term development. In these times of rising food prices, for food aid we used more cash to make purchases in the poor countries of the region, seeking out small farmers, we could have a double bang, as it were—helping poor urban consumers by also supporting poor campesinos. If we are successful in helping those countries prosper, their markets will grow and our exporters will wind up with far greater opportunities.
- **Fifth, there is a need to reduce the red-tape and eliminate the jerry-rigged bureaucratic creations that** now spread management of development funds over 20 different government agencies. For example, the FY2008 Consolidated appropriations bill for FY2008, including foreign operations funding, was signed into law on December 17, 2007 but was not finally allocated to USAID country missions until August, largely because of delays in the "F" bureau in State. In the case of some transfers from a bureau in State to USAID or to Justice—to enable USAID to fund human rights programs and Justice to support Colombia's Attorney General, allocations to USAID had not been made as of last Friday. Streamlining the flow of funds from Congress to a single development agency would remove that problem. So too

would having sufficient development professionals within USAID to avoid near total reliance on contractors.

Finally, we need more resources for development and to have the right overall strategy. Overall, military and economic aid in the FY2009 request for the region is about 30% more than it was eight years ago. Much of that increase is on the military side. Unfortunately, Administration development assistance (DA) requests where most of the funds would come from to finance the programs I believe are needed to address the region's challenges, have dropped steadily since 2001 and by 26% from FY 2006 to FY 2008. Also, while the Millennium Challenge Account provides much of the increase on the non-military side—with some welcome innovations in encouraging the right policy framework—compacts now cover only three countries, or 4% of Latin America's population. PEPFAR, the Administration's program to against HIV/AIDS, another source of international cooperation funding, and unquestionably its most important achievement of the Administration internationally, focuses in the Americas only on Guyana and Haiti. Much more is needed as a variety of bi-partisan review groups, the HELP Commission, the Modernizing Foreign Assistance Network, and Interaction all have argued.

There also is a need to re-think whether it is a good idea for the Department of Defense to be responsible for more than 20% of overall foreign assistance globally—even where the projects and programs are clearly for civilians, and no security issues exist. U.S. armed forces have enormous capabilities, but they are not trained to do development. Diverting them to that purpose is neither efficient from the standpoint of spending defense dollars nor desirable from the standpoint of achieving development results.

Secretary of Defense Robert Gates has argued that "One of the most important lessons of the wars in Iraq and Afghanistan is that military success is not sufficient to win: economic development, institution-building and the rule of law, promoting internal reconciliation, good governance, providing basic services to the people, training and equipping indigenous military and police forces, strategic communications, and more—these, along with security, are essential ingredients for long-term success." He noted that because of the absence of civilian agencies, the military stepped into the void, concluding, "But it is no replacement for the real thing—civilian involvement and expertise."

That is why many are arguing that the United States desperately needs a new national development assistance strategy and that the only way to ensure sufficient resources to implement it effectively is to have a single management structure, ideally a cabinet-level Department of Development that incorporates long-term development, conflict prevention and response and humanitarian action.

As Secretary Gates has noted, USAID has been gutted over the decades and needs to be rebuilt with sufficient personnel to carry out a national development strategy and the programs to implement that strategy. There were 15,000 USAID full-time workers in the 1960's, there are barely 3000 today. In certain narrow and time-limited ventures—the most insecure parts of Iraq and Afghanistan—improved and civilian staffed provincial reconstruction teams (PRTs) led by the military may be necessary. However, a doctrine is needed to define when they are required, to ensure their activities fit within the host country's development plan, to establish benchmarks for their transition to civilian-led teams with DOD support and ultimately their entire replacement by USAID. That doctrine and those benchmarks have yet to be developed. What is absolutely clear is that there is no need for those kinds of ventures in Latin America and the Caribbean.

Mr. ENGEL. Before I call on Ms. Birdsall, I want to just mention, since you mentioned Haiti and the problems and the devastation with four hurricanes hitting it, this subcommittee a week from today will have an emergency hearing on the devastation in Haiti. Among the people who will testify will be several of our colleagues who have just come back from Haiti who were there firsthand, and they tell me that the devastation is unlike anything you have seen before. So I wanted to mention that since you had mentioned it. And next Tuesday we will be exploring that here as well; and I hope that before Congress goes home we can help with extra aid to Haiti.

Dr. Birdsall.

STATEMENT OF NANCY BIRDSALL, PH.D., PRESIDENT, CENTER FOR GLOBAL DEVELOPMENT

Ms. BIRDSALL. Thank you very much——

Mr. ENGEL. You need to push your button.

Ms. BIRDSALL. Thank you very much, Chairman Engel, Congressman Burton and distinguished members of the committee. I am very pleased to have this opportunity. It is a privilege.

Before I go to the substance, I want to say first that I grew up in New Jersey, in Essex County, so I feel right at home in this particular committee hearing.

Second, that I am delighted to see Congressman Payne, and I had the honor of sharing participation in a panel with him in Denver at the time of the Democratic National Convention.

And, third, that I wanted to mention to the committee members that we have, apparently, visitors from Liberia who are members of the legislature there and the Center for Global Development has been working with the President in Liberia; and I think it is a really great opportunity for them to see democracy and the legislature at work on an issue that matters for Liberia as well.

I want now to have 5 minutes on three major issues of concern to the committee, if I may.

First, I fervently hope that Congress will work with the next President and the next administration in implementing a major overhaul of foreign assistance programs. I recognize that this is the way you started the hearings, Chairman Engel, in referring to Chairman Berman's interest in this particular issue.

Senator Menendez has made the case on the positive side for more foreign assistance in Latin America, the positive side opportunities for investment, the growing middle class and, on the risk side, drugs and corruption in Mexico, deforestation in Brazil. We could go on and on, as my colleague Mark Schneider has also made the case.

One tool in the foreign policy tool kit is trade. And I would like to acknowledge, although he is gone, the point that Congressman Burton has made. But the key tool in our foreign policy kit is foreign assistance. And the key issues I think for the work of this committee in the area of foreign assistance I want to reiterate, quoting from my colleague Steve Radelet, who testified recently to a different committee, three subpoints.

First, the outdated and unwieldy 1961 Foreign Assistance Act needs to be rewritten in a way that would establish a much stronger partnership between the executive branch and Congress, that would give more flexibility to the executive branch and have much more clarity about accountability to the Congress for the executive branch.

Second, the organizational structure for policy and implementation of foreign assistance needs to be completely restructured. This is the point that Mark Schneider just made. I agree with him, as do many others, on the fundamental need for a Cabinet-level department for global development and cooperation. In the three-legged stool that constitutes foreign policy—defense, diplomacy and development—development is clearly the weakest leg; and that is not good for Americans and for America.

And, third, in its approach to foreign assistance, the U.S. has to learn to work much more effectively with its allies in the coordination of aid programs, to be, in effect, far more multilateral. U.S. bilateral foreign assistance programs especially in Latin America are far too small to pretend that we can afford to give up the healthy leverage we have at the multilateral institutions and to give up exploiting that healthy leverage in a sensible way.

Let me go to my second issue. Let me say another word on the foreign assistance issue, which I think is a key challenge for Congress and for this committee, and that is to rationalize the current congressional committee structure which deals with foreign assistance programs, both to restore balance between authorizers and appropriators and to reduce the overlap and debilitating lack of symmetry which undermines Congress' strategic role and the ability to hold the relevant development agencies on the executive side accountable.

A very good example is oversight of U.S. policy regarding the multilateral development banks, which is currently shared on the House side alone by the House Foreign Affairs Committee, the House Financial Services Committee, the House Agriculture Committee and the Ways and Means Committee. And then there are, of course, the appropriations committees as well, and then there is the Senate side.

Like the aid programs themselves which the U.S. run, the committee structure is fragmented, lacks overall strategic vision and coordination and generates high transaction costs. I know this sounds naive, because I don't understand the constraints you face in addressing that issue, but I think it does take us back to the need for new authorizing legislation, to update an act passed in 1961.

Let me go to the second point and make it very briefly. I believe the Congress should urge the Treasury to press for faster and deeper changes at the Inter-American Development Bank, an institution of special interest to this committee where, as you mentioned, Mr. Chairman, I used to work. And at the World Bank as well. For most countries in Latin America, these institutions should become reluctant lenders. Instead of pushing loans, they should concentrate on deepening and expanding their role in the provision of technical advisory services, on investment machines, debt management, development of local currency markets, innovative approaches to delivery of education and health services, financing of health and pensions and so on.

My third major point I want to support but with one important reservation, the proposed legislation for establishing an economic and social and investment fund for the Americas. I would like to mention four good things about this bill and then mention my reservation.

First, on the good side, it will notably increase U.S. assistance for development in the region. This will help reverse the sense throughout the region that the U.S. is turning a blind eye to the tremendous problems of poverty and social exclusion that have been mentioned already by Senator Menendez and Mark Schneider in the sense that we are abandoning the people in the region to—

or abandoning the discourse on these issues and allowing that discourse to be monopolized by Chavez and others on the far left.

The second good thing about the bill is the increases implied, which are small compared to total spending in the region by governments themselves. They provide flexibility, however, which is the point, both to USAID and to the IDB; and they provide the kind of flexibility that USAID doesn't have now, for example, in dealing with the situation in Haiti, because of the numerous earmarks and mandates that Congress has imposed and that have accumulated over the last 25 years.

Mr. ENGEL. I am going to have to ask you to sum up, if I can. We will expand on it with questions.

Ms. BIRDSALL. Let me say that I applaud the emphasis in the bill on impact evaluation and mention my reservation about the bill, which is that the proposed new funds adds ironically to the existing fragmented and apparently ad hoc nature of U.S. foreign assistance spending overall. It is a good outcome given the context. I hope, however, that this committee will not let this particular good but limited legislation undermine your commitment to dealing with the larger reform that I emphasized in my first point.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Birdsall follows:]

PREPARED STATEMENT OF NANCY BIRDSALL, PH.D., PRESIDENT, CENTER FOR GLOBAL DEVELOPMENT

Introduction

Chairman Engel, Congressman Burton, and distinguished members of the committee, I am delighted to have the opportunity to share with you my views on the state of U.S. foreign assistance efforts in general and in the Americas more specifically.

As many of you know, the Center for Global Development is an independent, nonpartisan think tank dedicated to improving the policies of the rich countries as they relate to the world's poor countries and poorest people. Like this committee, we recognize the enormous opportunity that the 2008 U.S. presidential and congressional elections present to revisit the strategic rationale and the effectiveness of U.S. foreign assistance programs in Latin America and other developing regions. We look forward to working with the new administration, both parties in Congress, and our colleagues in the think tank and development advocacy communities to help ensure our foreign assistance programs not only reflect American values but effectively address the 21st-century imperative of promoting global prosperity and security globally in America's own interests.

I would like to raise and comment on three issues of concern to this committee.

First: I fervently hope Congress will work with the next president and his administration in implementing a major overhaul of the organization of foreign assistance programs.

As the saying ought to go, "The developing world isn't Las Vegas; what happens there doesn't stay there." Drug and corruption problems in Mexico, deforestation in Brazil, demagoguery in Venezuela—all these and other problems in Latin America, which you know well, affect our well-being here in the U.S. Although Latin America is less likely to become a source of terrorist activity or nuclear proliferation than countries in other regions, its geographic proximity binds our economic and social fortunes closely together. Its markets and natural resources create a rich set of investment opportunities in such areas as agriculture and energy security, and its growing middle class provides ample markets for U.S. exports. Mexico alone currently accounts for 12 percent of all U.S. exports—and U.S. exports account for almost all of what U.S. growth there has been in the last three quarters.

This committee and at least three recent bipartisan and independent commissions[1] have concluded that U.S. foreign assistance programs are vital tools for strengthening U.S. foreign policy and restoring American global leadership but are out of date and badly in need of reform. Let me mention several issues of key relevance for the work of this committee. (A full agenda for designing and implementing a major reform has been set out by my colleague Steven Radelet in recent testimony to the full House Foreign Affairs Committee last April[2] and in his chapter "Modernizing U.S. Foreign Assistance for the Twenty-first Century" in our book *The White House and the World: A Global Development Agenda for the Next U.S. President*.[3])

1. *The outdated and unwieldy 1961 Foreign Assistance Act* needs to be rewritten to streamline the overall goals, procurement rules, earmarks, and restrictions, and to reestablish a stronger partnership between the executive branch and Congress that allows greater flexibility toward the former provided there is greater accountability and responsiveness in the latter.
2. *The organizational structure for policy and implementation of foreign assistance needs to restructured and strengthened* by merging most foreign assistance programs and related development policy instruments into a new cabinet-level department for global development cooperation, by expanding and deepening the professional staff, by revamping delivery mechanisms, and by building a serious monitoring and evaluation system.
3. *The U.S. has to learn to work more effectively with its allies in the coordination of aid programs, and it must match its longstanding commitment to multilateral assistance programs at the United Nations agencies and multilateral development banks with increased contributions and greater attention to effective leveraging of those institutions' strengths.*

There is a growing consensus among development policy experts, practitioners, and development advocacy groups that these steps must be taken to improve our foreign assistance. The Modernizing Foreign Assistance Network—a group of academics, policy experts, development practitioners and advocacy groups—is actively engaging Congress and the presidential campaigns in calling for these reforms.[4] There is also a growing constituency in the U.S. for both more and better aid. Key polls show that regardless of political affiliation, gender, or race, a majority of Americans—more than 80 percent in one recent poll—support foreign assistance and see it as a way to restore American credibility and make the world a safer place.[5] The Bush Administration has effectively tapped this growing support and together with Congress managed to double U.S. foreign aid in the last eight years and to create the Millennium Challenge Corporation (MCC) and the President's Emergency Plan for AIDS Relief (PEPFAR).

I believe that the forces of bureaucratic and political inertia that have hamstrung a more comprehensive and durable reform for more than three decades can now be overcome—assuming there is leadership and vision in the new administration and Congress.

A key challenge in the Congress is and will be rationalizing the current congressional committee structure which deals with foreign assistance programs, both to restore balance between authorizers and appropriators, and to reduce the overlap and debilitating lack of symmetry that undermines Congress's strategic role and ability to hold the relevant development agencies accountable. One example: oversight of U.S. policy regarding the multilateral development banks is currently shared on the

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[1] "A Smarter, More Secure America: Report of the CSIS Commission on Smart Power," co-chaired Richard L. Armitage and Joseph S. Nye Jr. http://www.csis.org/component/option,com__csis__pubs/task,view/id,4156/type,1/; "Beyond Assistance: The HELP Commission Report on Foreign Assistance Reform," http://www.helpcommission.gov/; and "On the Brink: Weak States and U.S. National Security," A Report of the Center for Global Development's Commission for Weak States and U.S. National Security http://www.cgdev.org/content/publications/detail/2879.

[2] "Seizing the Moment for Modernizing U.S. Foreign Assistance: Testimony for the House Committee on Foreign Affairs," by CGD Senior Fellow Steven Radelet, April 23, 2008, http://www.cgdev.org/content/opinion/detail/15863/.

[3] "Modernizing U.S. Foreign Assistance for the 21st Century: An Agenda for the Next U.S. President" by CGD Senior Fellow Steven Radelet in *The White House and the World: A Global Development Agenda for the Next U.S. President*, Nancy Birdsall, editor, Washington, D.C., Center for Global Development http://www.cgdev.org/content/publications/detail/16560.

[4] "New Day, New Way: U.S. Foreign Assistance for the 21st Century", co-chaired by Steve Radelet and Gayle Smith, http://www.cgdev.org/content/article/detail/16211/.

[5] America and the World, Evolving Attitudes on National Security and Foreign Policy, The American Security Project, http://www.americansecurityproject.org.

House side by the House Foreign Affairs Committee, the House Financial Services Committee, the House Agriculture Committee, and the Ways and Means Committee—and then there are the appropriations committees, and then there is the Senate side. Like the aid programs themselves, the committee structure is fragmented, lacks overall strategic vision and coordination, and generates high transaction costs.

Second: I believe the Congress should urge the Treasury to press for faster and deeper changes at the Inter-American Development Bank, an institution of special interest to this committee, and at the World Bank. For most countries in Latin America, these institutions should become reluctant lenders. Instead of pushing loans they should concentrate on deepening and expanding their role in the provision of technical advisory services—on investment regimes, debt management, development of local currency markets, innovative approaches to delivery of education and financing of health, and so on.

Of course in the low-income countries of Central America, in Bolivia and possibly in Paraguay, both banks should continue to play the standard role as the multilateral aid vehicle which provides the glue, as World Bank President Robert Zoellick says, coordinating the many donors and creditors in close partnership with their borrowing members, and in some cases acting as a creditor or grantor of last resort. However, in the middle-income countries of the region, the banks should be encouraged to work out mechanisms for financing—at reasonable cost—their advisory services in technical, insurance, and financial areas, and for making it easier for countries to buy those services without borrowing.

At the same time, the banks should be urged to be more creative and aggressive in the support of cross-country, regional, and global public goods, in such areas as climate change and agricultural and health research and development.

I have written extensively on this issue, and would like one essay, entitled "From World Bank to World Development Cooperative," co-authored with my colleague Arvind Subramanian, to be entered into the record.[6]

Third: I want to support, but with some reservations, the proposed legislation for establishing an Economic and Social Investment Fund for the Americas.

There are many good things about this bill. First it will notably increase U.S. assistance for development in the region—which, depending on definitions, amounted to less than $500 million in 2007 excluding Plan Colombia and other anti-narcotics efforts. This will help reverse the sense that the U.S. is turning a blind eye to the tremendous problems of poverty and social exclusion that plague our neighbors and thereby abandoning the discourse on these issues to Chavez and the far left despite the obvious success of countries that have enjoyed leadership emphasizing a pragmatic combination of market-led growth with protection for the poor.

On the one hand, our foreign assistance programs for Latin America and the Caribbean are tiny relative to the size of the regional economies and regional government spending. Brazil, for example, spent 37 percent of its GDP on public services in 2004 and nearly $27 billion on education alone. The size of our foreign assistance programs pale in comparison to Venezuela President Chavez's largesse in the region and to the $10 billion that the richer economies of the European Union transferred to Ireland alone in the 1990s and will transfer in the next decade to Poland.

On the other hand, and this is the second plus with this bill, the increases implied in the bill give new flexibility to USAID and the IDB to test new modes of delivering grant money and give flexibility to countries in the region to test and evaluate their own new approaches (such as, in the case of education, incentive payments for teachers in rural areas, implementation of achievement testing, and special language and other programs for disabled children and marginalized indigenous and minority groups).[7] Grant resources also allow the U.S. to provide highly leveraged support for work on creating and fine-tuning the regulatory and financing framework for the major new investments in urban transportation, energy, port renovation and regional road infrastructure that are keys to attracting private investment.

Third, it makes sense to see the division of resources and labor between USAID and the IDB in the bill. USAID has long experience in the region but has been

[6] "From World Bank to World Development Cooperative," Nancy Birdsall and Arvind Subramanian, CGD Essay, October 2007, http://www.cgdev.org/content/publications/detail/14625.

[7] One new mode of delivering grant money that my colleagues and I have proposed is a "cash on delivery" approach to aid, under which donors would pay for measurable progress on specific outcomes pre-agreed with recipient governments. In education, donors could pilot "cash on delivery" aid by offering a contract to poor countries for $100 per additional child completing a quality primary education, to be used as the country chooses http://www.cgdev.org/section/initiatives/_active/pbaedu). These and other innovative aid mechanisms could leverage additional private philanthropic investments.

greatly weakened by the accumulation of congressional mandates and the loss of staff. I hope this legislation provides USAID a shot in the arm. The IDB has the capacity and the experience (including in the form of the Multilateral Investment Fund established as part of President George H.W. Bush's Enterprise for the Americas) to support innovative financial and social programs.

Finally, I applaud the emphasis given to serious impact evaluation, something my colleague Ruth Levine and others at the Center have strongly urged. I hope that USAID and the IDB will become members of the newly organized International Initiative for Impact Evaluation.[8]

My only reservation about this legislation is that the proposed new fund adds to the existing fragmented and apparently ad hoc nature of U.S. foreign assistance spending. It is a reasonable outcome in the absence of a broader strategy defining the purpose, size, and allocation of U.S. foreign assistance. I hope, however, that this committee will not let this particular (good but limited) legislation undermine your commitment to the larger reform I emphasized above.

Mr. ENGEL. Thank you very much, Dr. Birdsall.

Dr. Werker.

STATEMENT OF ERIC WERKER, PH.D., ASSISTANT PROFESSOR, BUSINESS, GOVERNMENT AND THE INTERNATIONAL ECONOMY UNIT, HARVARD BUSINESS SCHOOL

Mr. WERKER. Chairman Engel and members of the committee, I am honored by your invitation to testify here today. I will present a summary of my written testimony.

Foreign aid has been under attack from both sides of the aisle. While the United States has been the top donor globally, little was spent on the billion people who live on less than $1 a day. And according to a recent report, for every dollar spent on aid worldwide, only 18 cents actually gets spent on real development in the recipient country.

Meanwhile, an incredible phenomenon is occurring. In 2006, $600 billion in foreign direct investment and remittances flowed to developing countries, dwarfing the $100 billion in aid. In the Western Hemisphere, these flows of private development finance sent from the United States were over 35 times the $1.8 billion in foreign aid.

This finance is nothing to shrug off. Research has shown that FDI can raise wages and create jobs and that remittances reduce poverty and child labor. My colleague who is not here, Justin Muzinich, and I believe that government policy can and should act to shape the size, direction and nature of private development capital.

How might this work? Our proposal builds on two existing programs, the New Markets Tax Credit, which gives companies tax breaks on equity investment in poor communities inside the United States, and the Millennium Challenge Account, which increases foreign aid to countries with good governance.

[8] The International Initiative for Impact Evaluation (3IE) is a new international entity created to dramatically increase the number of rigorous impact evaluations in areas such as health and education to provide the global development community with more knowledge about what works when and where—and what doesn't (http://www.3ieimpact.org/). The 3IE is a membership organization that currently includes the Mexican Ministries of Health and Education, Ugandan Ministry of Finance, UK Department for International Development, Netherlands Ministry of Foreign Affairs, Canadian International Development Agency, Government of Denmark, African Development Bank, Bill & Melinda Gates Foundation, William and Flora Hewlett Foundation, Google, CARE USA, the International Rescue Committee and Save the Children (United States). The 3IE grew out of CGD's Evaluation Gap Working Group: "When Will We Ever Learn? Improving Lives through Impact Evaluation" (http://www.cgdev.org/content/general/detail/15102).

What we urge are tax credits for businesses for good FDI in qualifying countries and tax breaks to individuals for productive remittances to qualifying countries. This leverages taxpayer dollars to provide more resources; and, since the transactions are between private individuals, the usual hole-in-the-bucket fears of aid leakage are reduced.

Not just any FDI or remittances should qualify. The FDI would have to be the kind that creates jobs and brings in technological and management expertise, providing the recipient country with much-needed links to the global economy. Qualifying remittances would go directly toward postsecondary tuition, domestic microfinance loan pools or some other private sector engine of development.

Now the political challenge of implementing this proposal would no doubt rest on framing it as a component of a new 21st century American strategy of exporting our values while fighting global poverty. To make this work, we should limit the eligibility to relatively well-run market democracies. This would help to ensure that the money would get used well, and it would offer a powerful incentive to governments to reform.

Instead of coming from technocrats, the push for change would come from capital investors, who are providing jobs, and the diaspora, who are sending money. So that the program wouldn't hurt American workers, we would limit the investment credits to those countries where existing private aid flows are minimal and where per capita income is very low.

As it turns out, these eligibility criteria don't turn up much in the Western Hemisphere, which is generally richer and already receiving high amounts of FDI from the United States. But the sheer magnitude of FDI remittances to the region means that we need to think creatively about how to involve them in our development foreign policy, perhaps in more specialized vehicles.

Now let me turn to the legislation. Without planning it, I will be echoing the views of Dr. Birdsall.

Now three strengths of this bill stand out: The emphasis on rigorous evaluation and accountability; the increased attention to Latin America and the Caribbean, an important step given current events; and the role given to the IDB, an important institution for the hemisphere.

My reservations with the bill are a reflection of my view that the United States is due for a comprehensive foreign aid overhaul. Congress shouldn't have to establish an advisory committee and demand more accountability. The regular informing of Congress and vigorous evaluation should be a given for all foreign aid.

Let me finally comment on the Millennium Challenge Corporation, an important part of the U.S. foreign aid strategy in the hemisphere. The innovations of the MCC, using the promise of aid as a carrot to reward market democracies and an intense demand for accountability, can come into conflict with one another. Demanding accountability lowers the perceived reward to some qualifying countries, and the pressure to get money out the door pushes the organization to shirk on rigor.

The easy solutions are to compromise on rigor or to give up on the MCC being a serious catalyst for reform. But the correct response is not to back off on either innovation. Instead, it is to double down. We can do that by giving countries that meet MCC criteria not only aid but also a host of other rewards that reinforce their choice to be a market democracy. Tax breaks for remittances and good FDI should be extended to these countries in order to increase the flows of private development finance. Duty free and quota free trade access should follow. This would turn the existing modest reward for being a market democracy into a real jackpot and help us win and keep responsible friends abroad.

To summarize, private development finance has surpassed official aid flows, especially in the Western Hemisphere; and the dominance will only rise. As we conduct foreign assistance reforms, it makes sense to consider using the domestic tax system to shape the size, direction and nature of private development finance in a manner that leverages taxpayer dollars while decentralizing aid and empowering reformers around the world.

Mr. ENGEL. Thank you very much.

[The prepared statement of Mr. Werker follows:]

PREPARED STATEMENT OF ERIC WERKER, PH.D., ASSISTANT PROFESSOR, BUSINESS, GOVERNMENT AND THE INTERNATIONAL ECONOMY UNIT, HARVARD BUSINESS SCHOOL

Chairman Engel, Ranking Member Burton, and Members of the Subcommittee, I am honored by your invitation to testify today on the complex question of foreign aid reform as it relates to the Western Hemisphere. In this statement, I would like to discuss a proposal for foreign aid reform that I have developed jointly with Justin Muzinich, briefly comment on the legislation establishing a Social Investment and Economic Development Fund for the Americas, and make some recommendations on the Millennium Challenge Account.

Foreign aid has been the subject of vigorous public debate over the last several years. Among the complaints raised are that there is not enough aid to go around and that aid disbursements do not lead to enough development gains on the ground. Both critiques, though they usually come from different sides of the aisle, are to some degree correct. While the United States distributed $23 billion in 2006—more than any other country—relatively little reached the billion people who live on less than one dollar a day. In Latin America and the Caribbean, the $1.8 billion disbursed amounted to just three dollars per person per year. And, according to a Brookings Institution report, for every dollar spent on aid worldwide, only 18 cents actually gets spent on real development in the recipient country.

Meanwhile an incredible phenomenon is occurring with comparatively little policy engagement from the development community. Worldwide, *the flows of private development finance have surpassed official aid*. In 2006, $380 billion of foreign direct investment (FDI) flowed to developing countries and $220 billion in remittances were sent home by developing-country migrants. These numbers far surpassed the $104 billion in official foreign aid flows, and the difference will only grow. This private-to-public ratio of six dollars to one, worldwide, is dwarfed by the same statistic measuring U.S. engagement with developing countries in the Western Hemisphere. The $21 billion in FDI and $45 billion in remittances were over 35 times the amount of foreign aid sent from the United States to Latin America and the Caribbean in 2006. Private development finance is nothing to shrug off. Academic research has shown that FDI can raise wages and create positive spillover effects in the host country, and that remittances reduce poverty and child labor while insuring households against shocks.

A PROPOSAL: HARNESSING PRIVATE DEVELOPMENT FINANCE

Government policy can and should act to shape the size, direction, and attributes of private development capital rather than solely relying on the old model of government-to-government transfers. In so doing, we can leverage taxpayer dollars to provide more aid. And since the transactions are between private parties, the usual hole-in-the-bucket fears of losing aid to consultants or corruption are reduced.

So how can we use public policy to affect private transactions? Our proposal[1] borrows conceptually from two existing programs: the New Markets Tax Credit, which gives companies tax breaks on equity investment in poor communities inside the United States, and the Millennium Challenge Account, which rewards good governance through increased foreign aid to qualifying countries. What we urge are tax credits to businesses for good FDI in qualifying countries, and tax breaks to individuals for productive remittances to qualifying countries.

Some basic rules could be set up to make sure the private development finance encouraged by the tax breaks would get the most bang for the buck. Eligible FDI would be the kind that creates jobs and brings in technological and management expertise, providing the recipient country with much-needed links to the global economy. In fact, poor countries already spend their sparse tax revenue to attract this kind of foreign investment. Qualifying remittances would go directly towards post-secondary tuition, domestic microfinance loan pools, or some other private-sector engine of prosperity.

The political challenge of implementing this proposal would no doubt rest on framing it as a component of a new, 21st-century American strategy of exporting our values while fighting global poverty.

To make this work we should take a lesson from the Millennium Challenge Account. We propose that only those countries where—at the minimum—corruption is low, and governments are accountable to their people and respect human rights, should be eligible. This would help to ensure that the money would get used well, and it would offer a positive incentive for governments to reform. Of course, the incentive wouldn't work through the usual aid-conditionality mechanism that pushes reluctant governments to reform. Instead, it would motivate two huge constituencies to lobby their own government for meaningful change: capital investors, who are providing jobs, and the diaspora, who are sending money. So that the program wouldn't hurt American workers, we would limit the investment credits to those countries where existing private aid flows are minimal, and where per-capita income is very low.

As it turns out, our first pass of potential recipients did not turn up a single country in the Western Hemisphere. The reasons for that are twofold. One, relative to many underdeveloped countries in Africa and Asia, developing nations in the Western Hemisphere are richer. (Where they are not, like Haiti, corruption is too high.) Two, there are already relatively large levels of remittances and FDI flowing from the Unites States to developing countries in the Hemisphere. Tax breaks would likely end up subsidizing many transfers that would have occurred in the absence of the program.

APPLICATION TO THE WESTERN HEMISPHERE

The challenge for foreign assistance reform in the Western Hemisphere then becomes how to harness decentralized aid in the presence of significant existing private development finance. The low-hanging fruit that I have advocated above may not be appropriate for the Western Hemisphere. Instead, a more targeted set of tax incentives could be used to increase the impact of private development finance in a way that addresses chronic foreign-policy dilemmas in the region. I offer two specific examples.

One, migrants living in the United States could be allowed to deduct remittances from their pre-tax income if the remittances were invested in special long-term business-development funds in their home country. Qualified financial institutions could take the remittance deposits and make micro loans to small businesses. Migrants could commit to not withdrawing the money for a period of years. Not only would this provide credit through private channels, but it would leave the migrant a nest egg for her return to her home country.

Two, U.S. entrepreneurs could be eligible for a tax credit for all for-profit investment made in the social sector in qualified developing countries in the region. For instance, companies involved in village solar power for indigenous communities, or sustainable tropical forest eco-tourism, could qualify for the tax credits. Such a credit would tip the balance into profitability for a number of beneficial business ventures while stimulating American leadership in this emerging industry.

By involving private individuals and companies in market-friendly transactions between the United States and developing countries in the Western Hemisphere, such programs would offer a powerful alternative to Venezuelan-style assistance.

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[1] Muzinich, Justin, and Eric D. Werker. "A Better Approach to Foreign Aid." *Policy Review* 149 (June–July 2008). Muzinich, Justin, and Eric D. Werker. "A Global Tax Credit." Op-ed. *The New York Times*, October 20, 2007.

And if country eligibility were tied to low corruption and strong democratic accountability, nations would get rewarded for their commitment to just reforms. Importantly, the pressure would not come from Washington (which can be complicated when anti-American sentiment is high) but instead from the diaspora, and investors with a stake in the ground.

Of course, tax incentives are not the only answer. Traditional aid can, and does, fund programs that can make it easier for migrants to send (and for their families to receive) remittances. It can fund consultants to study the competitiveness of a country's business environment. Or it can set up a fund to make grants and loans to encourage private sector development, as with the Multilateral Investment Fund. *What tax incentives do differently from other instruments is decentralize the aid, which strengthens the direct links between America and its potential constituencies abroad.* The countless transactions between individuals, or corporations, would contribute to the rich web of relationships between the United States and the rest of the world.

EVALUATION OF H.R. 3692

Three attributes of the legislation establishing a Social Investment and Economic Development Fund for the Americas stand out as highly desirable. First is the emphasis on rigorous evaluation and accountability. Too often, we spend taxpayer dollars on unproven programs without spending the small amount extra that it would take to actually learn whether or not the program works. Advances in evaluation techniques make this omission even more inexcusable today. Second is the increased attention to Latin America and the Caribbean, which, given the threat of competing ideology in the region, is an important component of what should be a larger strategy. And third is the role given to the Inter-American Development Bank, and the payment of our Multilateral Investment Fund arrears. Multilateral aid offers a number of advantages over bilateral aid, and should receive a larger share of our development budget than it currently does. In today's geopolitical environment, strengthening international institutions that share our general worldview should be a priority. An increase in U.S. priorities getting implemented by multilateral or non-U.S. actors can only be a good thing. Sharing market development in Latin America and the Caribbean with the Inter-American Development Bank is in that spirit.

My reservations with the bill are a reflection of my view that the United States is due for a comprehensive foreign aid overhaul. The bill establishes an advisory committee and demands a different, higher level of accountability. This extra layer of oversight increases the cost of aid delivery and the complexity of reporting. It would be better if Congress could trust an executive agency to do its job and keep Congress informed, for *all* of its programming. Rigorous evaluation should also be a given for all foreign aid. And the thoughtful interpretation of this body of evidence, rather than specific earmarks, should inform the direction of all developmentally-oriented foreign assistance. Moreover, the $300 million per year that this initiative tops out at should be put in perspective. Compared to the $3 trillion in GDP in the region, this represents an injection of only 0.01 percent of the economy. In contrast, an African country like Tanzania receives nearly 15 percent of GDP in foreign assistance every year.

THE ROLE OF THE MILLENNIUM CHALLENGE CORPORATION

The Millennium Challenge Corporation (MCC), an organization with an important presence in the Western Hemisphere, embodies two distinct innovations in foreign assistance. One is in using the promise of aid as a "carrot" to reward countries that undertake their own positive reforms. The other innovation is the intense demand for accountability and measuring results. What I believe has occurred is that these two innovations have come into conflict with one another. But the correct response is not to back off on either innovation, which is the immediate political temptation. Instead it is to double down. I offer a concrete step to do just that, building on the proposal for aid reform that I have discussed.

When a body like the MCC demands that every financed project undergo a rigorous economic and environmental assessment, top-notch fiscal responsibility procedures, and submit to a serious evaluation, that can be tough news for the recipient country. High standards can make the carrot of a $500 million aid package seem less alluring than a much smaller amount in free money. At the same time, the pressure to get money out the door—in order to keep the carrot out there—pushes the organization to shirk on rigor (which the MCC has admirably resisted). The easy solutions are to compromise on rigor, or to give up on the MCC being a serious catalyst for reform.

Let me offer a different take that can serve as a model for how U.S. foreign assistance might interact with market democracies in the developing world. If a country meets certain MCC-type criteria, it should be eligible for not only a large and well-thought out aid package, but also a host of other rewards. All these rewards should reinforce the nation's choice of market democracy and create the constituencies to lock it in. Tax breaks for remittances and good FDI should be extended to these countries in order to increase the flows of private development finance. In addition, as has been suggested by the HELP Commission, duty-free and quota-free trade access should be granted to eligible countries. Adding carrots like these to the MCC eligibility prize package would turn the existing, modest reward for reducing corruption or educating girls into a real jackpot. It could invigorate the MCC in the process, and give forward-looking constituencies in poor countries ammunition for their quest to pursue a model of development that is in our mutual long-term interest.

SUMMARY

Private development finance has surpassed official aid flows, especially in the Western Hemisphere, and the dominance will only rise. As we conduct foreign assistance reform, it makes sense to think about harnessing those flows to benefit the developmental and foreign policy goals of the United States. *Using the domestic tax system is one such way to shape the size, direction, and nature of private development finance, in a manner that leverages taxpayer dollars while decentralizing aid and empowering reformers around the world.*

Mr. ENGEL. We have had three interesting witnesses, very good witnesses; and I am going to call on Mr. Burton to ask the first round of questions.

Mr. BURTON. Thank you, Mr. Chairman.

Dr. Werker—I don't have my glasses. Dr. Werker, that is correct, isn't it? Now, that is enough.

You go to Harvard or went to Harvard?

Mr. WERKER. I went there and I teach there.

Mr. BURTON. I see. Why didn't you go to the Big 10?

Mr. WERKER. Not big enough.

Mr. BURTON. Man, those Ivy League guys are tough, aren't they? You know——

Mr. ENGEL. When you have a debate with a doctor, you better watch out.

Mr. BURTON. I know. They are pretty sharp, pretty sharp.

You commented on using private sector more than—because it is more effective than government programs, or at least that is the indication I got from you. What can we do as a government—I mean, you mentioned giving tax incentives and so forth for these private institutions to invest down there. What else do you think we could do to utilize the private sector more dealing the problems we face in Central and South America?

Mr. WERKER. Thank you, Congressman, for the question.

While stating that I believe that we should involve the private sector, I don't believe necessarily that it is more effective at doing everything than regular bilateral——

Mr. BURTON. I guess the point I wanted to make is what can we do to encourage the private sector to do more so that the Government of the United States would not have to take on some of those responsibilities that are there?

Mr. WERKER. I think steps we can make toward our foreign assistance that decentralizes it would be beneficial in that it would reduce the administrative cost of handing out aid, and put the power of allocating resources in the hands of the people who are eventually going to use it. That is hard to do. Using the tax system is one way to achieve that. Using existing programs, trying to decrease the cost, for example, of sending remittances is another.

And we have also talked about trying to involve the private donors, the foundations and corporations directly in government programs. I think too much of that could actually be a mistake. Letting private philanthropists and foundations do their own thing is in itself an active strategy. And what we should be doing is looking for innovative programs that have been funded by foundations that might not have the same constraints as a government program—looking for successes in that situation and then trying to scale them up using government money.

Mr. BURTON. You mentioned just then reducing the cost of sending remittances back. What do you mean by that? I didn't know that there was a large or hefty cost in sending a remittance down to a Latin American country.

Mr. WERKER. Those costs have fallen substantially.

Mr. BURTON. Is that right? I was under the impression they were pretty substantial costs.

Mr. WERKER. They are relatively substantial. I believe—I am not an expert on this, but it might be on the order of 5 to 10 percent of the total amount.

Mr. BURTON. One other thing I was going to ask you, I am a big supporter of stabilizing Central and South American countries by increasing our trade. I think Mr. Weller is of the same opinion. What is your opinion, any of you, on what we should do regarding trade agreements with, say, Colombia and Panama and some of the other countries down there.

Mr. WERKER. If I could just answer first, I think we could take a lesson from one of the most tremendous development successes of the last couple decades, and that is in Eastern Europe. Countries undertook amazing reforms in order to become eligible for membership in the European Union, and this shows the power of desire for constituencies within the country. When they want to change the reforms and be a market democracy, that happens. Now, what that means for us to is to establish the same long-term rewards for countries that are willing to take tough changes in the short run, that they are going to experience rewards in the long run. And having trade agreements that we are committed to as well as potential other sets of resources, whether it's provided by the Millennium Challenge Account or through the domestic tax system, should signal to constituencies in those countries that they have a friend when they have made those reforms.

Mr. BURTON. Let me add one thing, too, and you can all answer this real quickly. The preferences that we have been giving in lieu of the trade agreements are about to expire. Can you give us your opinion on what kind of an impact that will have if we don't renew those before this Congress leaves? And then you can answer the other question as well.

Mr. SCHNEIDER. Let me start with that. It will have a devastating impact, particularly in the lowest income areas. For example, in El Alto in Bolivia outside La Paz, there are about 30,000 jobs estimated in what we would consider something like very low-scale employment, minimum wage in Bolivia, and those jobs will be wiped out if the—basically, if the access to the United States market were cut off through ending ATPDEA. It would worsen substantially social and economic pressures that, in our view, would increase the likelihood of destabilization and of conflict there. The same, I would say, in the case of Ecuador, and we do have now the bilateral trade agreement with Peru, but, again, ATPDEA for the moment is probably crucial for the other Andean countries.

Going back to your earlier question about—twofold, one the private sector, obviously to the degree if you increase jobs and trade and markets in Latin America, that is positive, but there is rarely going to be a situation where private sector business investment is going to directly impact on the areas of poverty reduction in those countries. It is simply not profitable. The other unremittances, though, we can do things, and we should look for innovative ways, and the IDB has taken back some steps, where remittances not merely go back to the family, but they go back to the community for improving public infrastructure and their decision about what they need in the community. That would be really fair and positive.

Mr. BURTON. If my colleague would indulge, can we have Ms. Birdsall make a response?

Ms. BIRDSALL. Just to respond to your question about trade and to show the bipartisan nature and nonpartisan nature of my views, I guess, I do think that the agreements that have been negotiated with Colombia and Panama should be passed as soon as possible in the Congress and have testified on that point to another committee in the past. I think that, in general, however, negotiating any additional bilateral agreements, we should be extremely cautious because the fact is that these bilateral agreements often end up imposing a kind of a bullying attitude from the U.S. on much smaller markets in demanding opening of capital markets and some details that for economists are important in affecting the poor in the region. And in any new bilateral agreements which are developed in the next few years, I think it is absolutely critical that there be flexibility on the aid side to provide for countries support for their domestic support programs that help the poor adjust. Just as we have trade adjustment assistance, we should be supporting countries, particularly in Central America, that don't have those safety nets and don't have the fiscal space to finance them in the short run.

Third, I endorse fully Eric Werker's point that all MCC countries should be given duty-free, quota-free access and that it should be permanent so that the question of whether unilateral preferences might be withdrawn, the threat that that poses, the chilling effect it has on future investment is removed forever for countries.

And, fourth, on the impact of not having a continuation of the preferences at least as a step, an interim step, prior to making such preferences permanent or agreeing in a treaty-like arrangement, I honestly think that the impact would be devastating over time, but it would come in the form of reduced investment from what would have been domestic and foreign investment. I am not sure that it would be an instant crisis of the kind that would wake us up to what are the much more fundamental long-run costs that those economies would face in loss of jobs, particularly for relatively unskilled people and particularly for women.

Mr. BURTON. Thank you.

Mr. SIRES [presiding]. Thank you.

I will let my colleague from New Jersey ask another question.

Mr. PAYNE. Thank you very much for your testimony.

I wonder as we—and the chairman is not here, but I am glad we are having a hearing on Haiti next week and the amount I heard earlier that, as you mentioned, $1 billion is what is necessary. And although the number sounds very grand, you wouldn't believe that just last week the United States decided to show our support for Georgia, which is a population of about half that of Haiti, and they are certainly a great ally, I don't think any closer ally than Haiti has been for centuries, but we are going to give $1 billion to Georgia just like that, just out of around the table somewhere last week. And they are getting $1 billion, and no one is even saying, wow, you know, it is just the right thing to do. But in Haiti, where we just continually have devastation, that some programs like reforestation and other kinds of programs that if we start now that could prevent the loss of life, so I hope that as we proceed, I will make that point certainly clear next week.

Let me just ask if there was a stronger regional organization—you know, in today's world we have regional organizations that seem to kind of shape the region's interests. We have the European Union, of course, and we have the Asian nations, whatever that group is over there. We have the African Union, which is reorganized from the old Organization of African States, the OAS. However, in Latin America and at least even in South America, if you took that part and looked at the organization of American states, it tends to seem to me not to be a very strong organization. It doesn't seem to be able to lobby itself well in the United Nations. It tends to be less effective as a regional group. And I just wonder what your opinions are.

We know that South America and Central America are very different in their interests and in their countries, their customs, but no more than you find in other parts of the world. So I wonder if anybody has any comments about their regional organization and whether there could be any strengthening or what would that matter.

Mr. SCHNEIDER. Yes, I do. I think that the OAS needs to be strengthened in several ways. Really it is the only organization in the hemisphere that is designed to provide a forum for political discussion and debate on the issues facing the countries as a whole. The fact is that historically, given the weight of the United States, the organization has always had difficulties in realizing its independent potential. Resources devoted to the OAS are very small. The OAS has very little in the way of independent analysis capability. It has very little in the way of a response. The ability—if it finds that there is a potential for conflict—to respond is minimal given its resources. It does not have the resources of the Department of Political Affairs with the United Nations to actually send people. The current Secretary General is actually trying to develop that capacity.

But the OAS budget, if you look at it over time, is actually less today than it was 10 years ago because of inflation. There has not been an increase in resources of any kind. We have argued that the OAS needs to develop an early warning capability with respect to potential conflict. There needs to be a coordinating mechanism for helping countries deal with that, and the OAS has to have some capability to send competent people out to use the resources. There are many capable people in the region. The OAS needs to be able to harness them and to bring them to bear on some of these problems, ideally before these things blow up. To be very frank, we never had that kind of discussion within the hemisphere and within this country about how we go about doing that.

Ms. BIRDSALL. Just to comment on the OAS, which I don't know nearly know so well as Mark Schneider, I would just like to say that the U.S. could do better at the time of leadership transitions in all of the international institutions. I think that the U.S. has allowed that transition often to be more about politics than about finding, using an open, transparent merit-based approach to acquire the leadership that will be most effective, including most effective in extracting from the member nations the resources that would strengthen the OAS.

The other thing I would like to say is that everything is relative, and although the OAS needs strengthening, it is probably among the regional institutions with the exception of the EU, which has a whole different character, one of the better, more effective ones, so it is worth thinking about how the U.S. could do better in leading via collaboration and cooperation in that institution.

Mr. WERKER. I would just like to add in a time, as Mr. Schneider has mentioned, when Ambassadors, American Ambassadors, have been recalled from countries, this is when our international institutions can be the most helpful. So now would be the time to have had a stronger OAS and to be enjoying its benefits. And sometimes having a strong international organization means ceding some direct leadership, allowing promotions to be base on merit, and to submitting some level of outcomes to the competent people who are working there. And when Ambassadors aren't able to do the job for you, then that is especially important.

Mr. PAYNE. My time has expired, but I have seen in other areas that you do have some of the strong countries on the continent, like Nigeria in Africa or South Africa, that would send in their leadership to negotiate problems. Of course, you haven't had the military kind of problems in Latin America, by and large. But there was always someone you can count on. Nigeria went into Liberia and settled it or into Sierra Leone, and I haven't ever seen any of that in Latin America. Maybe it is good, but sometimes you might need to have a rapid response initiative, even if it is a natural disaster, to have some kind of assistance ready to go in or some combatants ready to have peace and stability in a place that may make it shaky.

My time has expired. I yield back.

Mr. ENGEL [presiding]. Thank you.

Mr. Sires.

Mr. SIRES. Thank you, Mr. Chairman.

Mr. ENGEL. And thank you for sitting in the chair for a few minutes.

Mr. SIRES. My pleasure.

You mentioned Bolivia and Venezuela before and how they have asked our Ambassador to leave. We have programs there, and obviously, it has become a real hostile country. Should we continue with the aid to some of those countries?

Mr. SCHNEIDER. At the moment, we have very little in assistance with Venezuela. The assistance that we have in Bolivia I would say is threefold. One is directly related to our own counternarcotics objectives in terms of alternative development, working jointly on efforts to interdict the flow of cocaine out of the country. Second, remember Bolivia is the poorest country in the Western Hemisphere other than Haiti, and the areas where we work are generally on maternal and child health, on some environment, education, primary education and, to the degree possible, in trying to work on anti-corruption and rule of law. And every effort should be made, because those benefit the Bolivian people, to try to find ways that continue to fund those programs that benefit the Bolivian people that don't necessarily go directly to the government. I suspect that, hopefully, that option will remain after this afternoon's announcement by the State Department on certification.

I think an option may remain to continue aid, the kind of aid that supports basic human needs; the kind of aid that supports basic institutional strengthening. I think they are in the interest of the people of Bolivia and ultimately in our long-term interest of positive relations with that country.

Mr. ENGEL. I just want to call the subcommittee's attention to the fact that we are now having a series of votes on the floor, so we need to speed it up a little bit.

Mr. SIRES. Just out of curiosity, I read somewhere where Colombia, the Colombian Free Trade Agreement, Colombia is now looking toward Europe if this free trade agreement is not renewed. I was just wondering, are we pushing some of these countries toward Europe if we don't follow up on some of these agreements that we have with them, or is it conceivable that they could just pick up and deal with the European Union?

Dr. Werker.

Mr. WERKER. I think there is that danger. With lower trade barriers around the world, any country trying to escape from that system finds itself facing tons of other competitors who can simply fill in their place. And it would be, I think, naive to believe that the American market is that unique for a flexible investment that could occur in Colombia or another country were Colombia to change its own policies.

Mr. SIRES. Mr. Schneider, are we pushing these countries toward Europe?

Mr. SCHNEIDER. I think they will always look for the best markets and best advantage. Right now I would say that probably—even without the free trade agreement—my guess is that somewhere in the neighborhood of 70 percent of Colombia's products come into the United States without having to face significant tariffs. The issue it seems to me is going to be more about long-term planning by Colombian and other investors as to what their kind of future options are with respect to long-term investment.

Ms. BIRDSALL. Could I just say, on that question, I think that the cost of failing to pass the free trade agreement in Colombia is less likely to be in terms of any cost to our economy, our investors, our consumers and more likely to be a political cost associated with the lack of faith in the region in support for a President that has, in the face of many difficulties, made some sensible decisions. So it has more to do, in my view, with the declining sense of trust and neighborliness among Colombian citizens and voters with respect to the position of the United States and thus our loss of political leadership in the region in the face of virtually demagogic and populist movements that President Chavez represents.

Mr. SIRES. My concern is, will the other countries that will see how we were not able to live up to this particular agreement and say to themselves, well, there is a whole market out there in Europe that they seem to be pretty even for the next few years in dealing; so why not go to Europe? I mean, I would hate to see that happen because I think we will miss a great opportunity of such a close neighbor.

Ms. BIRDSALL. Yes. But they are probably doing that anyway as an economic decision. So you might have some loss of investment opportunities, but honestly, I think the issue is much more on the political side than the economic side.

Mr. ENGEL. Let me turn to Mr. Weller to ask a quick question. We have about 10 minutes and change to vote.

Mr. WELLER. Thank you, Mr. Chairman. You have been very kind for allowing me to return to this subcommittee for this important subject matter, and I want to thank our witnesses.

If you can forgive me for just sharing our Ways and Means point of view, as a member of the committee with jurisdiction over tax and trade policy, I want to make a couple brief comments on some statements by our witnesses.

Dr. Birdsall, you advocate permanency to the trade preferences, and I have always been an advocate of trade preferences, whether the Caribbean Base Initiative, which Ronald Reagan initiated, or the Andean Trade Preferences. And I believe that they should be extended not for 6 and 8 and 9 months at a time, but perhaps a minimum of 2 and 3 years at a time. The consequence I believe if we have permanency is, there is really no incentive for our partners to enter into a trade agreement with the United States if they have permanent duty-free access for their products. I make it from the standpoint of the farmers and the manufacturers that I represent in Illinois. Our ability to eliminate the 40 percent tariffs levied on manufactured goods in Colombia is lost if we make permanent trade preferences to our friends in Colombia. So I would disagree with you on that point of view. I think we need to maintain that leverage.

Second, and, Dr. Werker, I have always been an advocate of tax policies and encourage investment, but over the years, I have also been subject to political attacks over 2 years by my opponents claiming that I vote for tax cuts that ship jobs overseas, and while those tax provisions do not exist, it makes for great political theater. So from the standpoint of actually being able to find someone willing to advocate tax incentives to encourage investment in foreign countries, that may be a heavy lift from a political standpoint.

Earlier, when Senator Menendez was here, I asked Senator Menendez, from his point of view, how we can leverage the private sector because we have seen $4 billion this past year invested in Latin America and various programs and assistance by private organizations. Every time I set foot and get ready to board a plane to Latin America, there is always some very enthusiastic group of American citizens who are affiliated with a church or an organization wearing T-shirts, and they are off to do some mission somewhere in Latin America, and I believe that you would encourage that. But I often wonder, from the standpoint of the State Department, USAID, do we do an effective job of partnering with these organizations? Could we be more effective in helping encourage this type of activity and also to direct this kind of activity in a way that helps develop the institutions? Because I have been an advocate of the trade preferences because they help reduce poverty. I am an advocate of trade agreements because they enlist trade as a way of reducing poverty. And if we truly want to strengthen democracy, poverty reduction, which is preyed upon—the populace of the world, whether in Latin America or elsewhere, they always prey upon the poor, and that is who they try to enlist in their cause. So, I think, if you believe in democracy, you want to reduce poverty.

Dr. Schneider, from your perspective, your work at USAID and your work in the Peace Corps, how can we do a better job of enlisting these private groups but also finding ways to foster the focus in areas that are of mutual benefit in reducing poverty and strengthening the institutions of democracy?

Mr. SCHNEIDER. Very quickly, it seems to me that you always have to recognize there is going to be a balance. Yes, you could do more to engage them, to have them think about how they can ensure—let us say that they are having good labor agreements, that they are ensuring that their workers have access to benefits that are at least at par, that they encourage their colleagues in those countries to adopt the kinds of policies that do help in reducing poverty. For example, let us take Guatemala, that they should work with their colleagues in trying to encourage decent levels of tax revenues to a government to provide education and health care and rural infrastructure investment, which doesn't exist. So, yes, we could do more with them directly. But then I think you also have to have government-to-government support for institution building.

Mr. WELLER. I would note that if you look at the record of American corporations doing business in Latin America, it is usually the American companies that have set the standard when it comes to providing health benefits and ensuring that employees' kids are in school, for example.

Mr. ENGEL. I am going to let that be Mr. Weller's last word because we only have a few minutes. But I want to ask two very quick questions, and if we don't have time for you to answer them, if you could get me a written answer, I would appreciate it.

While the logic for U.S. military forces participating in disaster relief is clear and largely accepted by the civilian developmental community, the rationale for military engagement in phase zero or nonemergency settings in Latin America, for example, is less clear and more controversial. So let me ask you this: What role should the Defense Department through the U.S. Southern Command, SOUTHCOM, play in providing nonsecurity assistance to Latin America and the Caribbean? If anyone wants to try that?

Mr. SCHNEIDER. Definitely. I think that that is the wrong way to go. The military does fantastic things, but this is diverting them from what they are trained, from what they are most able to do. Yes, humanitarian relief, when that is what is needed, they have enormous logistic assets. But in terms of engaging in areas of long-term development, as they have discussed, infrastructure development, that should be the role of the civilian agencies, the U.S. Government and the private sector and civilians agencies in the countries where they are working.

Mr. ENGEL. Thank you.

Dr. Birdsall.

Ms. BIRDSALL. Let me agree with Mark Schneider and to add that the only reason that it is happening—well, we should think of its happening as a symptom of the fundamental need for an overhaul of our foreign assistance programs. The fact is that it is happening in part because the military has the resources that are much less scrutinized by the relevant committees of Congress, the Armed Services Committees, dollar for dollar, way less scrutinized than are the dollars spent by USAID, the Millennium Challenge Corporation, and so on. So we should see this question as itself a symptom of a great challenge for this and other committees in the Congress.

Mr. ENGEL. Thank you.

Dr. Werker.

Mr. WERKER. I believe every U.S. Government employee overseas is a de facto Ambassador for our country. And to have the military be the main face of development sends an interesting message to the countries in which we are doing that development assistance.

That said, the military certainly does have a role to play as some of the issues in the continent are security, and other agencies like the FBI could be of assistance to their colleagues in law enforcement agencies inside countries to fight important issues like crime and drugs.

Mr. ENGEL. Thank you.

Let me ask one final question, and I am going to go across to both of you, and you could just answer yes or no. In my opening statement, I mentioned how Brazil has the 11th largest economy in the world, the largest in Latin America, and one of the largest in the developing world. But it is also home to 50 percent of the people in Latin America defined as poor, and there are 35 million people in north and northeast Brazil living in poverty, and yet our levels of aid to Brazil have been steadily declining over the past few years. So if you take a country like that, which is almost paradoxical, should the United States increase developmental assistance and other types of foreign aid to upper middle-income developing countries like Brazil and also Mexico with large pockets of poverty?

So let me start with Mr. Schneider, yes or no?

Mr. SCHNEIDER. Yes. There are current budget cuts proposed for Brazil from $15 million to $8 million and reductions as well in Mexico, except in the noncounternarcotics areas. They should be increased, but probably different kinds of programs because they have different capabilities.

Mr. ENGEL. Thank you.

Dr. Birdsall.

Ms. BIRDSALL. No. But I would leave it ultimately up to the executive branch at the moment when opportunities or crises arise, but fundamentally no.

Mr. ENGEL. That we should not continue aid to those countries?

Ms. BIRDSALL. Right. Aid as money.

Mr. ENGEL. Right.

Mr. WERKER. I think it's dangerous to mess with a well-run country that already has established its own government-citizen relationships. Large amounts of money can distort the accountability that the government has to its own people.

That said, a small amount of symbolic aid to certain poor pockets if it were acceptable to the larger community in that country could be helpful.

Mr. ENGEL. Thank you.

I think that will have to be the last word because we have got to run for a vote. I want to thank all three of you for your testimony and for your good work. Thank you.

The hearing is now adjourned.

[Whereupon, at 4:15 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

ADDITIONAL MATERIAL SUBMITTED BY THE HONORABLE MARK SCHNEIDER, SENIOR VICE PRESIDENT, SPECIAL ADVISER ON LATIN AMERICA, INTERNATIONAL CRISIS GROUP, FORMER DIRECTOR OF THE PEACE CORPS, 1999–2001

Latin American Drugs I: Losing the Fight, Latin America Report N°25
14 March 2008

Summary

Coca leaf and cocaine production in the Andean region appear to have set new records in 2007. Cocaine trafficking and use are expanding across the Americas and Europe. Despite the expenditure of great effort and resources, the counter-drug policies of the U.S., the European Union (EU) and its member states and Latin American governments have proved ineffective and, in part, counterproductive, severely jeopardising democracy and stability in Latin America. The international community must rigorously assess its errors and adopt new approaches, starting with reduced reliance on the measures of aerial spraying and military-type forced eradication on the supply side and greater priority for alternative development and effective law enforcement that expands the positive presence of the state. On the demand reduction side, it should aim to incarcerate traffickers and use best treatment and harm reduction methods to avoid revolving and costly jail sentences for chronic users.

Well-armed, well-financed transnational trafficking and criminal networks are flourishing on both sides of the Atlantic and extending their tentacles into West Africa, now an important way station on the cocaine route to Europe. They undermine state institutions, threaten democratic processes, fuel armed and social conflicts in the countryside and foment insecurity and violence in the large cities across the Americas and Europe. In Colombia, armed groups derive large incomes from drug trafficking, enabling them to keep up the decades-long civil conflict. Across South and Central America, Mexico and the Caribbean, traffickers partner with political instability.

Insufficient international cooperation and coordination – in particular between the U.S. and Europe but also between them and Latin America – has worked to the advantage of the drug networks. Displaying great resourcefulness, the narco-organisations exploit the policy divide between the U.S. and the EU and some member states over how best to define and conduct counter-drug strategies and which aspects of cocaine supply and demand reduction efforts should be given priority. Since there is no shared vision of the problem and how to address it, there is no concerted response, which is a necessary condition for success in dealing with transnational crime.

Non-ideological policy rethinking is urgently required on key aspects of supply reduction. Law enforcement and interdiction would benefit from closer coordination and information sharing throughout the Americas and with Europe, but much greater recognition is also needed of the pressures produced by extreme poverty, lack of economic opportunities and basic infrastructure, and government abandonment of indigenous populations in the Andean countryside. National and international policies must include much larger investments to address the structural factors that make it easier for traffickers (in Colombia, illegal armed groups), to attract or compel rural families to cultivate coca. Aerial eradication, with impact on nearby food crops, and forced

eradication by security forces, nearly always accompanied by charges of human rights abuses, engender anti-government and anti-U.S. reactions.

Cocaine demand is the driving force behind production and trafficking. That demand is largely stable in the U.S. and rising in some European and Latin American countries. Unless it can be significantly reduced around the globe, there is virtually no possibility of overcoming the threat to security in much of Latin America. The "one size fits all" criminal incarceration policies prevalent in the U.S. ignore the potential in greater attention to treatment of chronic users and stigmatising recreational users. At the same time, the prevention, treatment and harm reduction measures more prominent in Europe, where too few resources are dedicated to breaking up trafficking rings, have not stemmed increasing drug use. In 2008, ten years after the UN General Assembly Special Session (UNGASS) on the world drugs problem, the international community needs urgently to acknowledge mistakes and adopt fundamental policy improvements or transnational criminals will be the winners.

Crisis Group's detailed study is divided into two complementary reports published simultaneously. This report principally examines the scope of the problem, including a detailed examination of cultivation and trafficking. The second, Latin American Drugs II: Improving Policy and Reducing Harm, analyses policies and their political and social ramifications and presents policy recommendations.

Latin American Drugs II: Improving Policy and Reducing Harm, Latin America Report N°26
14 March 2008

Summary

The policies of a decade or more to stop the flow of cocaine from the Andean source countries, Colombia, Peru and Bolivia, to the two largest consumer markets, the U.S. and Europe, have proved insufficient and ineffective. Cocaine availability and demand have essentially remained stable in the U.S. and have been increasing in Europe. Use in Latin American transit countries, in particular Argentina, Brazil and Chile, is on the rise. Flawed counter-drug polices also are causing considerable collateral damage in Latin America, undermining support for democratic governments in some countries, distorting governance and social priorities in others, causing all too frequent human rights violations and fuelling armed and/or social conflicts in Colombia, Bolivia and Peru. A comprehensive shared policy reassessment and a new consensus on the balance between approaches emphasising law enforcement and approaches emphasising alternative development and harm reduction are urgently required.

Counter-drug policies such as the U.S.-Colombian Plan Colombia and the European Union (EU) Drugs Strategy have not found an effective mix of supply and demand reduction measures. While on both sides of the Atlantic the lion's share of counter-

narcotics funds are invested in controlling the drug problem at home, neither the Washington law-enforcement orientation nor the Brussels public health orientation (which is not homogeneously shared across the EU) has significantly reduced cocaine use. Policy coordination between the U.S., Europe and Latin America is severly hampered by the marked differences on both how best to address the world's overall drug problem and how to reduce cocaine supply, as well as by unrelated political disputes.

While the U.S. runs large supply reduction programs in the Andean source countries, in particular seeking to eradicate coca crops through aerial spraying in Colombia but also investing considerable money in alternative development, the Europeans contribute on a smaller scale to the establishment of alternative livelihoods and strengthening of institutions. Drug-shipment interdiction and law enforcement in many of the transit countries are relatively major elements of U.S. policy, while Europe attempts to guard its borders closer to home and suffers from inadequate law enforcement cooperation within the EU.

In the absence of better coordination between counter-drug authorities on the three continents, highly efficient and sophisticated transnational trafficking organisations adapt rapidly and continue to find ways to cater to the world's most lucrative markets. The harm they do is multiplied by their symbiotic relationships with illegal armed groups, most spectacularly the insurgents and the new groups that have sprung up following disarmament of the paramilitaries in Colombia.

Crisis Group's detailed study is divided into two complementary reports published simultaneously. The first, Latin American Drugs I: Losing the Fight, principally examines the scope of the problem, including a detailed examination of cultivation and trafficking. This report analyses policies and their political and social ramifications and presents policy recommendations.

RECOMMENDATIONS

To the U.S. Government:

1. Increase demand reduction efforts by:

(a) expanding public drug education and prevention programs at high schools and developing high-impact programs targeting other cocaine and crack cocaine users;

(b) increasing drug courts and improving treatment referral and treatment programs for chronic users;

(c) offering more and more effective in-prison, transition and treatment follow-up programs;

(d) increasing systematic information exchange on drug prevention, treatment, rehabilitation and law enforcement with European and other drug authorities; and

(e) developing modern communication approaches to stigmatise recreational users of cocaine.

2. Refocus supply reduction efforts by:

(a) increasing massively the alternative and rural development, institution-strengthening and local governance components of Plan Colombia and the Andean Counter-Drug Initiative (ACI);

(b) changing the Colombia coca crop eradication program from all too often indiscriminate aerial spraying to manual eradication, linked to immediately available economic incentives for farmers, and limiting forced eradication to a last resort there and in Bolivia and Peru;

(c) increasing information exchange with the EU and Latin American source countries on supply reduction;

(d) reinstating Drug Enforcement Administration (DEA) helicopter interdiction operations in Haiti based on the successful 2007 pilot operation;

(e) focusing more interdiction efforts closer to, and on, U.S. borders, particularly the Mexican, where the loss of cocaine is costlier and not as easily replaced by traffickers as in the source countries;

(f) establishing stronger cooperation with EU and Latin American law enforcement/counter-drug agencies to improve interdiction closer to U.S. and European borders and be more effective at dismantling trafficking organisations;

(g) targeting more effectively cocaine brokers and wholesalers in the U.S. and increasing efforts to control and dissolve street gangs and reintegrate their members into civil life; and

(h) increasing the focus of the Mérida Initiative on strengthening institutional and law enforcement capabilities in Mexico and Central America, with a priority on addressing corruption.

To the European Union and its Member States:

3. Increase demand reduction efforts by:

(a) expanding public education and prevention programs in the member states, especially in Italy, Spain and the UK, aiming specific programs in particular at high school students and middle-high and high income groups;

(b) expanding treatment programs specifically tailored to cocaine and crack cocaine users, particularly in Italy, Spain and the UK;

(c) evaluating rigorously the impact of harm reduction and law enforcement measures on reducing cocaine demand and taking appropriate action to improve performance; and

(d) increasing systematic information exchange on drug prevention, treatment, rehabilitation and law enforcement with the U.S. and other drug authorities.

4. Increase supply reduction efforts through:

(a) expanding significantly support for alternative and rural development, institution-strengthening and local governance programs in source and transit countries and improving coordination and harmonisation of programs between the EU and the member states;

(b) establishing systematic information exchange with the U.S. on supply reduction measures in the Latin American source and transit countries;

(c) improving European law enforcement coordination for better interdiction of cocaine shipments closer to European borders and within the EU and to be more effective at dismantling trafficking organisations;

(d) establishing stronger cooperation with U.S., Latin American and West African law enforcement and counter-drug agencies to increase the effectiveness of interdiction and chemical precursor control; and

(e) targeting more effectively cocaine brokers and wholesalers in the EU.

To the Governments of the Andean Region:

5. Increase supply reduction efforts by:

(a) expanding massively alternative and rural development, institution-strengthening and local governance programs aimed at addressing historical absence of state presence, indigenous exclusion and rural poverty and including these issues prominently in international cooperation agendas;

(b) shifting the focus of coca crop eradication to manual and, where security conditions permit, voluntary eradication, while progressively phasing out aerial spraying and forced manual eradication;

(c) establishing stronger cooperation with law enforcement agencies in Latin America, Europe and the U.S.;

(d) strengthening control of chemical precursors; and

(e) closing the loopholes in the system of legal coca leaf control in Bolivia and Peru.

6. Increase demand reduction efforts by:

(a) designing and implementing public education and prevention programs and offering drug users treatment; and

(b) establishing systematic information exchange on demand reduction with other Latin American countries, Europe and the U.S.

To the Governments of Brazil and the Southern Cone:

7. Increase demand reduction efforts by:

(a) acting promptly against increased cocaine and "paco"/"merla" use in Argentina, Brazil and Chile;

(b) significantly improving and expanding public education, prevention and treatment programs tailored to cocaine and "paco"/"merla" users and targeting high school students and lower, middle and middle-high income groups; and

(c) establishing systematic information exchange on demand reduction with other Latin American countries, Europe and the U.S.

8. Increase supply reduction efforts by:

(a) improving control at international airports and borders with Bolivia, Paraguay, Peru and between Brazil, Argentina and Chile;

(b) increasing law enforcement intelligence capabilities on organised and transnational crime and expanding cooperation with law enforcement agencies in Latin America, the U.S. and Europe;

(c) stepping up law enforcement against domestic and transnational trafficking organisations, targeting their organisational structures, financial and other assets and drug-producing facilities;

(d) increasing the fight against corruption in law enforcement agencies and significantly improving conditions in and performance of the prison systems;

(e) improving control of chemical precursors; and

(f) increasing efforts to control and dissolve criminal gangs in poor neighbourhoods of the large cities and reintegrate their members into civil life.

To the Governments of Mexico, Central America and the Caribbean:

9. Increase supply reduction efforts by:

(a) strengthening the fight against corruption within law enforcement agencies and the military, including by proceeding swiftly to create new police forces or reform existing ones;

(b) replacing the military progressively by police and civilian law enforcement agencies in the fight against drug trafficking and taking prompt action to improve the human rights records of the military and law enforcement agencies;

(c) targeting more effectively senior and mid-level structures of Mexican trafficking organisations and increasing efforts to control and dissolve criminal gangs in poor neighbourhoods of the large cities and reintegrate their members into civil life; and

(d) increasing the focus of the Mérida Initiative on strengthening institutional and law enforcement capabilities in Mexico and Central America.

10. Increase demand reduction efforts by:

(a) improving and expanding public education, prevention and treatment programs tailored to cocaine and crack users and targeting high school students and lower, middle and middle-high income groups; and

(b) establishing systematic information exchange on demand reduction with other Latin American countries, Europe and the U.S.

To the United Nations:

11. Conduct a rigorous and transparent evaluation, with civil society participation, of the progress worldwide in reducing supply and demand for drugs since the 1998 UN General Assembly Special Session (UNGASS) on the world drugs problem.

12. Promote establishment of a new policy consensus, capable of overcoming current political divisions, and strengthening cooperation and policy coordination between the U.S., Europe and Latin American source, transit and consumer countries and achieving an effective balance between demand and supply reduction measures.

To the Organization of American States:

13. Continue to evaluate progress in reducing drug supply and demand in the OAS member states and promote strong cooperation between Latin America, the U.S. and Europe.

CENTER FOR GLOBAL DEVELOPMENT ESSAY

FROM WORLD BANK TO WORLD DEVELOPMENT COOPERATIVE

By Nancy Birdsall and Arvind Subramanian[1]
October 2007
http://www.cgdev.org

The World Bank should become a more active catalyst for generating global public goods and knowledge and a more reluctant lender to governments

The World Bank and the International Monetary Fund (IMF) have new faces and fresher minds at the helm to confront the crises of relevance and legitimacy they both face. The incoming Managing Director of the Fund, Dominique Strauss-Kahn, is in some ways luckier than Robert Zoellick, the World Bank President installed in early July, because the problems of the Fund are obvious and immediate. Spurred by the risk that China, India and other rising emerging market economies will disengage, the Europeans and Americans have agreed to give them and other developing countries more votes and more influence. Though the details of this fundamental reform are far from entirely settled, and while there remain doubts about whether the reform will be adequate, at least the die has been cast. The impetus for this and other fundamental reforms is all the more urgent and proximate because as borrowing from capital-flush emerging markets has plummeted, the Fund is increasingly unable to cover the cost of its operations from current income.

In contrast, the problems at the Bank are less obvious and immediate, and there is little impetus for fundamental reforms among the Bank's powerful member countries. For one thing, the Bank's income position is not seriously threatened. Even if middle-income borrowing, its profit generating machine, shrinks, the Bank has enough income-earning capital to finance current operations for some considerable time. Moreover the G–7 and other rich country members, along with even the Bank's fiercest critics, continue to support the Bank's engagement in Africa and in low-income fragile states in general—where the Bank's combination of financing and technical help are still without peer. From some points of view, less staff time and energy in middle-income countries implies more for Africa. Finally, the Bank as a bureaucracy, though big and dauntingly complex, has kept its many constituencies reasonably happy over many years, by accommodating effectively more and more tasks: reconstruction in Bosnia, a carbon trading facility, the recovery of assets stolen by former leaders of oil states—to name just a few. Whether this is flexibility or mission creep, its protean ability to be all things to all parties has kept its influential "stakeholders" reasonably happy.

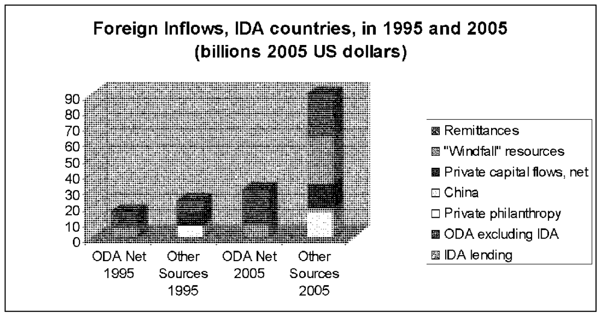
THREE FUNDAMENTAL PROBLEMS AT THE WORLD BANK

Yet the Bank faces three central problems that require major rethinking.

First, even in the poorest countries, traditional lending by the World Bank and other official creditors to governments is facing new competition. The growing stock of billionaires-with-a-conscience is creating a large pool of private philanthropic funds; China is becoming a large bankroller of selected (usually resource-rich) African countries; the global liquidity glut is providing cheap private capital to developing countries; and many poor countries have received windfall "resources" in the form of higher commodity prices. Of course, whether cheap private capital and higher commodity prices are cyclical or secular factors remain open. But the current numbers are nevertheless striking.

For developing countries as a whole Bank lending accounts for less than 5 percent of overall resources.

[1] The authors are respectively, President, Center for Global Development, and Senior Fellow, Center for Global Development and Peterson Institute for International Economics.



And even more striking, for the poorest countries (those eligible for loans from the Bank's concessional lending window, IDA), lending and grants account for less than 8 percent of all external resources, down from about 17 percent in 1995 (see Figure). On top of this, the World Bank has become a smaller player even among the official donors: its share of official concessional transfers (called Overseas Development Assistance—ODA) to IDA countries, for example, has fallen from almost half to less than one-third in the last decade as the U.S. and Europeans have pumped up their aid programs.

Moreover the implicit contractual underpinnings of this official lending—we the rich give cheap money and you the recipient deliver on reform—have proven flawed. Conditionality has not worked. Privatization, trade liberalization and other reforms have taken hold, or not, largely independent of Bank loans. Outsiders—no matter how great the financing they transfer—can have influence at best at the margin on what are essentially home-grown transformations. Countries that have what it takes to grow (institutions, human capital, policies, commitment etc.) can almost certainly find the resources, especially given the increase in the number of willing providers of aid. For countries that don't have it, the marginal returns from additional resources, even with the technically correct strings attached (and there is reasonable debate about what is technically correct anyway) have been limited.

Second, the World Bank's fundamental mission—to reduce poverty through shared growth in the developing world—is threatened by global public "bads" such as climate change and global pandemics. Though the Bank has increased its attention to these "bads" in its country lending programs, its involvement has been and remains limited and ad hoc. Lacking a clear mandate from its member governments, it has never had the kind of flexible funding that would allow it to deploy its considerable economic and technical expertise effectively—to complement country-based loans with global strategic leadership.

Third, and most problematic, is the Bank's own governance crisis. Its big middle-income borrowers have never had much power or influence at the Bank—which explains their lack of resistance despite their unhappiness with the U.S. once again monopolizing the selection of the World Bank head. Now flush with capital and unscathed by the recent liquidity crunch in OECD markets, they need Bank financing less and have even less reason to waste geopolitical chips on arguing for an increase in their voting rights and influence. They can negotiate harder within the current framework (they just extracted a lower interest rate on their outstanding loans in return for eschewing resistance to the Bank's using its income to finance lending to the poorest countries). But they cannot win a change in the framework. Yet without the greater engagement of the middle-income countries the Bank risks losing its global cooperative nature. It cannot be politically effective in dealing with climate change—just one example—and risks becoming simply another aid agency managed by the rich countries to provide assistance to the poorest countries.

TRANSFORMING THE BANK: THREE MAJOR CHANGES

All this ought to imply major changes for the World Bank in scope, size and structure: a greater focus on global public goods, a reduction in the number and costs of traditional loans and grants (and consequently a likely reduction in staffing), and a change in the Bank's own financial and governance arrangements to ensure full engagement for developing countries in decision-making and agenda-setting.

In his first annual meeting speech, Mr. Zoellick addressed these challenges only partially and indirectly. We believe in the next year he needs to embrace fully and directly the Bank's twin crises of relevance and legitimacy in a changing world, heeding the counsel offered to the Sicilian Prince in Lampedusa's great novel, *The Leopard*: "If we want things to stay as they are, things will have to change."

1. More global public goods (GPGs)

The two defining challenges of our times are global warming (and energy management more broadly) and persistent underdevelopment and poverty in certain parts of the world, notably Africa. Less global warming and in many senses reduced poverty are both classic global public goods (GPGs), and both are under-supplied.

Take global warming. Without collective action to minimize greenhouse gas emissions and develop local systems for mitigating its impact on people, not only will the planet be affected, but the Bank's mission of reducing poverty in the world will be at great risk. Global warming's greatest impact will be on the poorest countries in Africa, the Pacific islands, Bangladesh and India. Not just livelihoods—agricultural potential in India, Brazil and many of Africa's tropical countries could decline by 60 percent and more in the next 70 years—but physical survival will be at stake.

Turn next to development, where better technologies in health, agriculture, communication and information systems could be transforming. Around the world, there is a tendency for research and development (R&D) to be under-supplied because it is difficult even for public suppliers (such as the National Institutes of Health in the U.S.) to capture for their citizens alone all the benefits. But R&D of products of interest to poor countries is even more undersupplied—because a limited consumer market reduces potential private returns, and because the governments of Kenya, Peru and even research-rich India are each reluctant to finance a good from which the others will benefit.

The Bank should as quickly as possible oversee a major effort to see how global warming can be addressed (building upon the existing Global Environment Facility), including, for example, monitoring and surveillance of any agreed reductions by countries; and how R&D for new technologies for poor countries can be substantially increased. The first step is to secure and allocate (including to relevant UN agencies for actual deployment) greatly increased financing for both these objectives. The World Bank and other public and philanthropic groups currently spend in the millions on tropical health research, while the top pharmaceutical companies spend about $45–$50 billion on R&D devoted almost entirely to rich country diseases. Similarly, Monsanto, the private corporation that is a major player in agriculture, spends about $700 million on R&D compared with total spending by the international public agricultural research institutes of only about $100 million (of which less than $20 million is spent on agricultural research for Africa).

But over time the World Bank's role will need to go beyond financing to the development and piloting of new GPG products. The recent invention of a mechanism called the Advance Market Commitment (AMC) illustrates the tasks involved. In its first application, the AMC involves a firm commitment by several government donors and the Gates Foundation to purchase a given quantity at a given guaranteed price of a vaccine to prevent certain pneumococcal diseases. It took almost ten years for a good idea—to create a market-like incentive for private industry to invest in medicines for neglected tropical diseases—to be turned into an actionable policy proposal that would generate these pledges. The effort was not fundamentally financial; it involved technical and legal analysis, convening and persuasion—the kinds of activities that require cooperative and collective effort that meets the GPG test.

The Bank's absence from that product development process (until its late stages, when the G–8 requested its help in clarifying technical and financial details) is not in retrospect surprising, since it lacks any clear mandate to work on such global public goods and is organized and managed primarily to lend to individual governments. But that should change. The Bank could make a valuable contribution even now to extending the AMC concept for application to malaria and AIDS vaccines, to a drought-resistant cassava, and so on.

Markets are notoriously slow in creating new products and new ideas for development; hence the case for public intervention. Another example where current Bank efforts are beginning to yield fruit—though again due more to individual staff initiative than any real mandate to develop new markets—is in such risk-sharing financial instruments as index-linked GDP bonds and catastrophe bonds (e.g. for small Caribbean countries for which hurricanes and similar weather shocks pose major difficulties).

The Bank has an impressive research capacity, and has also been successful in what might be called global knowledge creation with major global spillovers. A good example is the Costs of Doing Business Surveys. These have allowed individual countries' performance to be benchmarked against other countries and against their own past performance with salutary (name-and-shame) effects on the incentives for reforms. And Bank staff are developing such new products for the aid community as "output-based aid," under which private water firms are paid by a donor on the basis of water connections made in poor neighborhoods—in this case once again outside traditional Bank work, at the specific request of the United Kingdom, which is financing the product development through a Trust Fund at the Bank.

The Bank itself need not be directly involved in all such experiments. But it should have clear responsibility for distilling the knowledge from others' efforts and disseminating them. Though it has recently stepped up its efforts in systematic evaluation and learning about the impact of programs it itself funds (supported mostly by special funds not by the Bank's own budget), it has not played any role in developing better evaluation of other aid suppliers' programs or even of recipient countries' own development interventions. It has yet to support an existing international initiative to do just that (another global public good "developed" outside the Bank)—presumably because interested staff are stymied for lack of a clear mandate and available Bank financing.

We are not suggesting that the Bank has no involvement now in the development and financing of global public goods. In fact its financial and technical contributions to the work of the Global Environment Facility are manifest; it has helped initiate an Asset Recovery Program in which banks and governments agree together to return to developing countries assets stolen and transferred abroad illegally—reducing the incentives for corrupt behavior in open global capital markets; and it is a longtime contributor from its own capital and earnings to the international consortium on agricultural research from which came the Green Revolution in South Asia. Indeed the constant demands on the Bank to be involved in global programs, because of its technical expertise and sometimes because of its financial capacity, demonstrate the point: that it is singularly set up to exploit its comparative advantage in addressing development challenges that require collective action at the global level. The problem is that for the last five decades these activities have been ad hoc, out of the mainstream of Bank work, and poorly funded by the Bank and by the world. Even the new efforts on the environment are too project-based and country-focused when in fact a new strategic shift to addressing the problem of global climate change is overdue.

Consider the following anomaly. On the one hand, the returns from GPGs are demonstrably high: for example, it is estimated that the global returns on research on new strains of high-yielding wheat and rice carried out in the 1960s and 1970s were about 40 percent. On the other hand, the results of government-to-government (G2G) lending, in terms of its growth impact, are at best mixed. Even the most ardent champions of aid would not claim returns of that magnitude for G2G lending. Yet look at the current allocation of World Bank lending and administrative expenditure between GPGs and G2Gs. Of the $25 billion in Bank/IDA transfers to the developing world last year, about $23 billion took the form of loans and grants directly to individual countries, and only the remaining $2 billion (primarily grants) can be clearly counted as financing global programs (such as CGIAR for agricultural research). On the one hand this is not surprising, given the Bank's decades-long tradition of making country loans. On the other hand, it no longer seems responsive to 21st-century challenges.

Of the World Bank's annual administrative operational expenditure of $ 1.3 billion, a breakdown by major units suggests that a larger percent—about 25–30 percent—could be considered GPG-related. But that reflects not a coherent strategy but the accumulation of specific requests (usually made by its non-borrowers and sometimes directly financed by them) for its knowledge services, as well as the fact that some country-specific research and technical advice has benefits for other countries via acquisition of experience.

2. Reluctant lending, active advising

The Bank's member countries should also adopt a new stance with respect to its longstanding product: the financial transfer via a loan or grant to a developing country. We call the new stance that of a "reluctant lender". This is not an argument against transfers to developing countries, but against the Bank making loans (or grants) its priority, as opposed to responding much more selectively and differentially to countries' varying and changing needs—whether for conventional financing or other services.

The rationale for the subsidized provision of financial and other (knowledge, technical assistance) resources to developing country governments has not disappeared. Yet for at least two reasons, the Bank should be more reluctant than in the past to lend. First is the fact that there are many more aid suppliers for the poorest countries and greatly increased private capital flows to emerging-market and middle-income countries than twenty and certainly than fifty years ago. That suggests a more careful evaluation of the Bank's particular comparative advantage and in some cases a reduced role for it in direct financing.

Instead, the Bank should make its priority that it become an active adviser (with or without lending) to all its member countries on the "business of government". Its knowledge development and sharing services at the country level should be financed internally by an expanded core administrative budget, completely de-linked from a country's loans, policies, programs and income levels. (To the extent this is already the case, the relevant "core" should be a much larger portion of total country operations budgets.) Expanded core services would build on and constantly replenish the Bank's comparative advantage in the crowded aid industry, i.e. the worldwide experience of its staff across and within sectors and countries—on expenditure management, governance, anti-corruption programs, environmental standards, procurement management, pension and labor market reforms, education, health financing and so on—preserving and extending the brain trust that constitutes the Bank's true comparative advantage relative to other financiers in middle- and low-income countries.

Whom to lend to?

What are the implications of the Bank's being a reluctant lender and an active adviser for various groups of countries? Consider first, whom it lends to.

Among the poorest countries, those with good leadership and reasonable competence should be eligible for loans and grants—but only to the extent Bank transfers fill a gap other donors fail to fill. In the "donor darlings" (Tanzania, Mozambique, Mali, Ghana), the Bank's financing should come only as the residual, and as we discuss below, not in the form of traditional "projects". Some rule of thumb—that no country should be receiving more than 40 percent of its own government spending from outside sources—should constrain total transfers, with the Bank exercising the key discipline when needed. In countries without minimally competent and honest government (for example, in many of the failed states or what the Banks calls low income countries under stress (LICUS)), donors reasonably want to effect transfers directly to the poor without adding to the resources of governments. The Bank, by mandate, is poorly set up to engage in such retail giving; it should leave that to others—philanthropic foundations, mostly private agencies and NGOs supported by bilateral donors. It should avoid lending or grant-making altogether—while continuing its core work as an active and engaged adviser.

Some countries that are growing rapidly and able to finance investment domestically (China, India, Brazil, Russia and many other emerging-market and middle-income economies), are currently not only receiving private capital inflows but are actually exporting capital and accumulating high reserves. In such cases, there is little justification for financial transfers from the Bank, with the sole exception being Bank-managed direct subsidies to encourage those countries' commitments to reducing such global "bads" as climate change. Global financial and liquidity shocks could justify transfers to these countries in the future, but these anyway should be modest since major transfers in times of crisis (such as those to Korea in 1998) are provided more appropriately by the IMF.

Of course, some poor and middle-income countries have good leadership and reasonable competence but still limited access to private capital at reasonable prices and terms (Mali, Senegal, Paraguay, Guatemala, the Philippines). In these the Bank's loans should be important not for their size or number but as a signal to markets, internal as well as external, that the policy and regulatory environment will support adequate returns to good investment, that government manages resources effectively on behalf of the public, and that minimum environmental and other safeguards are in place.

How to lend?

Since conditionality of the sort practiced in the past—detailed, monitored ex post, project- and loan-specific—has seldom actually worked, it is time to abandon it and move toward ex ante standards of country performance that are transparent to citizens and activists around the world. As a reluctant lender, the Bank should lend only to countries that meet those minimum standards. We recognize that setting and honoring the resulting thresholds for lending will not be technically or politically easy. But as in the case of IMF surveillance on financial issues, there will be convergence over time to useful and practical thresholds. The Bank already practices a roughly equivalent approach on a limited basis for low-income countries, whose loan and grant allocations are based on the Bank's internal measure of governance and overall competence (called the Country Policy and Institutional Assessment).

Where it does lend, the Bank should move away from projects and toward less cumbersome, more hassle-free loans, largely in the form of budget support (or, in a more radical version of hassle-free lending, the Bank could simply agree to buy a large portion of sovereign bond offerings). The project approach wrongly assumes that outside resources are largely non-fungible. In the Bank's early years, the great development economist Rosenstein-Rodan was at a loss to explain "the psychoanalytical problem why a bunch of intelligent people" should be taken in by this "optical illusion" of non-fungibility. The Bank may think that it had financed an electric power station, he said, "but in fact financed a brothel."

Among other benefits hassle-free budget support would help undercut the culture of over-lending. The way the bank is currently structured, sectoral departments within regions compete with each other to demonstrate the importance of their sectors, which leads to building up larger loan portfolios as an indicator of importance so that more loans can be justified and so on. That is why the move toward budget support (in the past in the form of so-called adjustment loans) has historically been fiercely resisted by sectoral departments, fearful of losing their bureaucratic influence. In fact, since outside resources are at least partly if not wholly fungible, it is governments, not Bank officials, that actually determine priorities.

One insistent refrain from critics is that the Bank should have a clearer notion of what it should not do. But beyond the view that the Bank should steer clear of culture and religion, no one has ever gotten any agreement on what ought *not* to be done. Indeed it is clear that over more than 60 years, sectors and issues have always been added and never subtracted. In fact that is because it makes sense for the Bank to house expertise on the full range of development issues—that is what creates and sustains its comparative advantage. The reality is that sectoral needs and priorities vary across countries and regions and change over time. There is no way these can be determined globally or established permanently. In our approach, any reduction in Bank activity would be a consequence not of eliminating one or more sectors or areas of expertise but of more demand-driven lending and of streamlined modalities for how such lending takes place.

Pricing and unbundling of financial and knowledge services

For the Bank to become an active adviser requires that it price its advisory services, unbundling those services from loans so that countries (including those with no need to borrow) can "buy" advice beyond the core to which they would be automatically entitled. Given the Bank's widely acknowledged culture of over-lending and its relatively weak mechanisms of evaluation, its shareholders as a group need some mechanisms, however imperfect and rudimentary, to help determine the "value" of its various services relative to its competitors—and to help push its management and staff toward those services in which it has a comparative advantage as a global institution. Unbundling and appropriate pricing would contribute toward this objective, allowing some measure of "true" demand to be discovered for the individual products offered by the Bank.

An example of one approach to pricing would be to charge IBRD countries the cost of services minus say 10 percent; IDA countries cost minus say 50 percent; and those IDA countries eligible for grant financing, cost minus 80 percent. The minus principle takes into account the fact that these services allow for constant acquisition of new experience and knowledge from which all countries benefit.

Governments might resist unbundling because, for example, they believe the demands of preparing and appraising a loan enhance the quality of knowledge services provided by Bank staff and make staff more responsive; borrowing from the Bank might also be a device for governments to discipline certain ministries or sub-federal entities. These arguments, however, simply suggest keeping the traditional loan-advice bundle as an option. They do not justify the current implicit practice of discouraging requests for advice in the absence of borrowing.

It must be acknowledged that the Bank could lose some of the learning and knowledge acquisition as it becomes a reluctant lender and thus is less intimately involved in designing and implementing projects. But lending is likely to decline in any case, given the growing importance of other financiers. If the Bank is to continue to contribute as only it can, retaining its strength as a uniquely global repository of knowledge about development, it needs now to acquire experience in how to learn without lending.

Third-party evaluation

Finally, given the uncertainties about aid effectiveness and the need for the Bank to be a learning, self-correcting institution, it needs to finance evaluation of its own work by third parties. Under the structure that we envisage, evaluation will focus less on projects and more on broader issues—for example whether the Bank has created incentives for countries to meet common global standards and how effective has been the Bank's surveillance of countries' financial, environmental and other management capacities.

3. Reforming the Bank's own governance

The Bank's founders set up a cooperative. In an initially club-like spirit, there was no clear distinction in the late 1940s between the Europeans, the initial borrowers, and the one creditor country, the U.S. In the 21st century, the Bank has the opportunity to return to that cooperative spirit, in which its major strength is its capacity to acquire and share development expertise and develop and finance attacks on difficult global collective action problems—which if not addressed will delay or even undo the Bank's traditional work to reduce poverty and transform developing country societies.

The Bank's comparative advantage in knowledge sharing (over commercial consulting and academic advice) and in work on GPGs derives from its credibility as an honest broker representing its members' own interests, at least in principle. But its current governance, dominated by the U.S. and other creditors, is not representative, preventing it from exploiting fully its comparative advantage. For example, its advice on policy reform has never achieved the kind of "ownership" at the country level that it could, in part because as an institution it is viewed as reflecting the interests of the G–7 more than the interests of its borrowers. And its advice might have been better in some instances (on sequencing of liberalizing reforms for example) had its Board better reflected the experience and views of developing countries.

So any changes in the Bank's activities and products will require some restructuring of its governance. Two changes are fundamental. First, an open, transparent and merit-based selection process for the next World Bank president needs to be formalized, including agreement that nationality of future candidates should not be an issue. Second, developing countries must be better represented, both in terms of voice on the Board and voting power. There are many sensible suggestions for restructuring the Bank's governance in a manner that would leave in place the effective veto power of creditor countries (which has helped ensure creditors' ongoing support for the Bank's work) while ensuring that developing countries have sufficient influence to warrant their full engagement. For example, such key issues as the choice of the president can require veto-proof pluralities or double majorities of weighted votes and countries.

Without a change in its governance that encourages input and engagement of China, India, Russia, and Brazil, it is unlikely that the Bank can raise the resources to back effective exploitation of its technical and strategic advantages to deal with global climate change. Without a change in governance that ensures that Africa and the countries of the Middle East have input on its policies and practices, the Bank will not have the legitimacy that has to back its advice and counsel to its member countries on making globalization inclusive. Indeed without a change in governance, it will remain politically difficult to work with China on development projects in Africa, and to convince Africa that work on climate change is not a distraction from work on poverty reduction.

COVERING COSTS, FUNDING GPGS

All of these suggestions, of course, lead to one of the big problems that any restructuring will have to grapple with. For decades the Bank has relied on income from its loans to finance its own costs, rather than on annual contributions from governments (the dreaded UN model). Reduce this lending, say the proponents of the status quo, and the Bank stands to become like the UN, subject to the whims and vagaries of national legislatures. Moreover, contrary to the widespread misconception that reduced lending to middle-income countries would free up Bank resources for the poorest countries, it is quite the opposite. Net income from lending to Brazil, Turkey and other middle-income countries has actually helped finance the Bank's concessional loans and grants to the poorest countries—as those middle income countries have often pointed out (and blocked at, for example, the Inter-American Development Bank where they have greater voting power). To the extent this is true, however, it is a highly non-transparent and somewhat inequitable mechanism for sustaining the operations of the Bank and helping support the poorest countries.

Could a bank that became more active in GPG generation and less active as a lender be financially viable? Take the extreme case where profits from lending disappeared altogether. The Bank's endowment (in the form of paid-in capital) of about $30 billion, would generate an annual income in perpetuity of about $1–1.5 billion. That compares with current administrative costs of $1.3 billion. With a re-orientation in scope and modalities (fewer missions to develop highly detailed "projects"), administrative costs ought to come down. And revenues would be greater than otherwise to the extent countries" buy" advisory services. Of course, with no income from lending at all, the Bank would not be able to transfer some of its income to IDA (projected at about $4.5 billion for the next replenishment), or finance the write-down of debt as it did under the HIPC program in the past; these would have to be financed from direct contributions (which would be more transparent). With some income from hassle-free loans, the currently relatively small transfers to CGIAR and other non-Bank global programs (less than $1 billion) could still be supported. More to the point, except in the extreme case of losing all income from lending, the Bank would be able to sustain its own knowledge-sharing work. And in any event, an interim period that sees gradually declining lending to middle income countries should provide the time for restructuring Bank finances.

Less clear is the question of how to enlarge the Bank's role in financing major new global programs such as technology development and greenhouse gas emission reductions. The Bank is currently (in late 2007) seeking to replenish its fund for low-income countries, to the tune of $30 million over three years being sought from the Bank's non-borrowing "rich" members. One proposal would be for Bank management to similarly launch a major round of contributions for its GPG work. All countries, however, including China, India and middle-income countries, should be asked to make some contribution to what should be a GPG Fund—in which all contributors could have influence and votes inversely related to their economic size and positively to their contributions.

CONCLUSION: A WORLD DEVELOPMENT COOPERATIVE

In discussions of the international financial architecture, the Fund has come to recognize that its future lies less in its financial role than in its regulatory and supervisory roles. It is time for a parallel re-thinking at the World Bank. As with the Fund, the Bank is no longer the sole or even major supplier of funds to developing countries. Yet its global reach and technical depth puts it in a key position to expand and enhance its advisory services and help manage such pressing collective action challenges at the global level as global warming, the development of new health and agriculture technologies, and the need to make markets for new financial and other products. All of these are "development" opportunities that go beyond business as usual at the Bank. All require a change in the rules by which the Bank is governed to ensure greater engagement of the developing countries in the Bank's business. Without their engagement the World Bank will become simply another aid agency confined largely to the overcrowded business of making transfers to the poorest and most marginal countries. And the world will lose what it desperately needs: a global institution addressing the global challenges of the future through global collective action.

Background and further reading:

The 2005 CGD Working Group Report, "The Hardest Job In The World: Five Crucial Tasks for the New President of the World Bank," offers five bold but practical recommendations for restoring the legitimacy and increasing the effectiveness of the world's largest development institution. The five tasks are:

- revitalizing the Bank's relevance for its big middle income and emerging market borrowers;
- greater differentiation across the poorest countries in the nature of its operations;
- creation of a grant fund for global public goods;
- taking the lead on independent evaluation of all aid spending;
- and reforming the governance of the Bank itself, including changes in the composition of the Bank's board and a more open selection process for future Bank presidents.

For additional readings by these authors on reforms of the International Monetary Fund and the World Bank, including on the World Bank as a credit cooperative, see Nancy Birdsall, "The World Bank: Toward A Global Club," in Global Governance Reform: Breaking the Stalemate, eds. Colin Bradford Jr. and Johannes Linn, The Brookings Institution, 2006, also available at CGD Publications; and Birdsall, "Why It Matters Who Runs the IMF and the World Bank," in Globalization and the Nation State: The Impact of the IMF and the World Bank, eds. Gustav Ranis, James Raymond Vreeland, and Stephen Kosack, London, UK, 2006, available at CGD Publications; and, on the role of the Bank in low-income countries, Birdsall, Dani Rodrik and Arvind Subramanian, "How to Help Poor Countries," *Foreign Affairs*, 2005.