Assessing the Millennium Challenge Corporation as a Model for Foreign Assistance Reform

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WORKING PAPER[1]

[1] This paper can also be found at the *United States Agency for International Development's Development Experience System (DEXS)* http://dec.usaid.gov

Executive Summary:

US foreign assistance, also known as “foreign aid” or simply “aid,” is a US government (USG) system that uses American tax dollars to influence and develop other nations. Consequently, aid management carries significant responsibility, and we as a nation must ensure it is executed as effectively as possible. The objective of this study is to find an effective aid model applicable to the future of US foreign assistance.

This study explores three models for US foreign assistance administration: A) Pre-MCC—USAID-administered aid until the end of 2003; B) Status Quo—the post 2003 system, including the MCC and administration under the Director of Foreign Assistance (DFA); and C) Restructuring US foreign aid along a MCC model—hypothetically channeling more DFA-administered funds through the MCC. The effectiveness of each aid model is assessed using five criteria: (1) Alignment, (2) Development Theory, (3) Political Control, (4) Accountability, and (5) Results. If a model passes the effectiveness criteria within its given time period/framework it is deemed effective. Subsequently, the study considers if the most effective model would be feasible in the future.

Analysis of models A and B suggests neither is exceptionally effective within its framework, and so both are ineffective models for future foreign aid. This same analysis, however, discovers the MCC’s ability to avoid complex procurement processes, quickly write and sign Compacts, award aid to demonstrated good performance, maintain accountability mechanism(s), and avoid many restrictions of congressional earmarking—all of which make the MCC, by itself, a fairly effective instrument of aid. There are still some elements of the program needing improvement.

The study finds several limitations with Model C, and so discounts the assumption that because the MCA/MCC is an effective instrument of foreign assistance simply expanding it *as is* would spread its benefits on a larger scale. MCC restrictions on recipient entities and number and duration of contracts limit Model C. It is also uncertain how politically acceptable the model will be as many politically attractive aid programs are not necessarily transferable to the MCC framework. The model may also jeopardize funding for MCC eligible countries currently benefiting in Model B.

Although simply expanding the current MCC/MCA system via Model C is not the most effective way to administer aid, some additions to its framework might create a more effective aid model applicable to the future. We call this amended model “Model D.” Model D would slightly increase funding for the MCC Compact Program and allot additional DFA-administered funds to the current Threshold Program and a new program called Threshold Gold. A “disaster preparedness” and “inequality” indicator are added to current MCC programs. Several other small reforms are proposed.

By following Model D, the study concludes the USG can spend significant portions of aid along strategic and ideological lines without substantially increasing the foreign assistance budget, and still notably increase the effectiveness of foreign assistance.

Introduction

US foreign assistance, also known as “foreign aid” or simply “aid,” is a US government (USG) system that uses American tax dollars to influence and develop other nations.[2] Consequently, aid management carries significant responsibility, and we as a nation must ensure it is executed as effectively as possible. The objective of this study is to find an effective aid model applicable to the future of US foreign assistance.

Various models of foreign assistance have been proposed over the past century. Reforms have tried to address criticisms that US foreign aid is a giveaway program, inefficient, lacks accountability, shows few positive results—and according to some— is inherently futile. Most reform movements, aside from the 1961 reform creating the Foreign Assistance Act, have been failures.

Recently, the Millennium Challenge Account (MCA) and Millennium Challenge Corporation (MCC), both created in 2004, have been praised as one of the potentially most effective instruments of US foreign aid. As one test of aid effectiveness, this study explores whether funds from the budget administered by the Director of Foreign Assistance (DFA), which includes development funds within the United States Agency for International Development (USAID) and State Department (State), should be channeled through the MCC given the MCC’s alleged effectiveness.

This study accepts that much of US foreign assistance, with the possible exception of humanitarian aid, has and will continue to have a “strategic” and “ideological” focus: i.e. aid will not necessarily be awarded to countries based on comparative need, but instead based on objectives of the USG, donors, and the American people. This definition of strategic and ideological aid will be used for the remainder of this study.

Methodology

The study collects data via literature review and interviews. Primary data sources are EBSCO, MCC website, congressional reports and testimony, internet searches for pertinent websites, and interviews with senior USAID/MCC staffers.

The study assesses current problems with the US foreign assistance system using information from literature review and interviews, then coupled with individual analysis. It then analyzes the MCC/MCA as a system of foreign aid with MCC reforms as of mid 2007 and predicts what would happen if the system was expanded. No sources were found comprehensively answering the research question of this paper, giving indication it is a unique study.

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[2] The United States is the largest international economic aid donor in dollar terms but is the smallest contributor among major donor governments when calculated as a percent of GDP.

This study explores three models of US foreign assistance administration: A) Pre-MCC—USAID-administered aid until the end of 2003; B) Status Quo—the post 2003 aid system, including the MCC and administration under the Director of Foreign Assistance (DFA); and C) Restructuring US foreign aid along a MCC model—hypothetically channeling more of DFA-administered funds through the MCC. The effectiveness of each aid model is assessed using five criteria: (1) Alignment, (2) Development Theory, (3) Political Control, (4) Accountability, and (5) Results. If a model passes the effectiveness criteria within its given time period/framework it is deemed effective. Subsequently, the study considers the feasibility of structuring the aid system after the most effective model.

Criteria for Aid Effectiveness	Description
Alignment/Harmonization	Efficient and competitive procurement, financial management, and coordination processes—appropriate entities are awarded aid money in a timely fashion; monies do not overlap unnecessarily
Development Theory	(1) **macroeconomic stability** is often equally important to economic growth as is bottom-up development *(2) **corruption** tends to make economies less efficient *(3) **country ownership**: buy-in and country involvement in the development process almost always produces the most successful development programs. (4) **institutional strength** is a key element in societal and economic health (conversely, policies themselves may or may not lead to development although their relation to economic growth may be more defined)
Political Control	Government has reasonable but not overwhelming control of aid programs
Accountability	Proper accountability mechanisms are in place
Results	Aid measures up to mission/goals established by the distributing institution

The Models

Our three models most specifically, albeit still broadly, focus on aid administered by USAID, USAID/State, and the MCC. They do not specifically discuss aid programs administered by other agencies, e.g. DoD, DoA, Treasury, etc. Still, to some degree, the models inevitably cover management and policy issues shared by the entire US foreign aid system. Each model is only meant to assess very general trends in aid distribution within its given framework, and so this analysis does not demand difference-in-difference(s) testing or delineation of precise percentages of overall foreign aid being discussed. For reference, however, the models analyze an average of 55% of the overall US foreign aid budget.[3]

This study makes several assumptions. It assumes a blanket pre-MCC model, although broad, has value. For history wonks, separate 1961-1973, 1973-1990, 1990s, 2000s pre-

[3] The models analyze anywhere from 30-80% of the US foreign aid budget in any given year, given the particular agencies/institutions mentioned. Given Model C's (and Model D's) rather inevitable effect on the overall Foreign Operations appropriations budget it/they almost certainly encompass more of the overall aid budget.

MCC, and 2004-2007 models may be more revealing of specific trends in USAID foreign assistance, and may be good topic(s) for other studies. The study also assumes that simply "increasing the amount of the US foreign aid budget" (e.g. to 0.7% of GDP—sic the UN Millennium Project, Jeffery Sach's *The End of Poverty*, etc.) is a rather generic aid model on which an abundance of research has already been performed, but has thus far proven infeasible. Accordingly, Model C (and subsequently Model D), do not rely on increasing the *overall* foreign aid budget, but rather redistribute(s) a larger *percentage* of foreign aid to the MCC.

Importance of Criteria

Alignment/Harmonization:[4] Aid projects are most likely effectively implemented when their promoters and designers are still in positions to implement them. Time lags and non-competitiveness due to burdensome contracting and procurement procedures make aid less effective. Overlapping and poorly coordinated projects and finances also make aid less effective.

Development Theory: While there are many important principles of development theory, this study will only use four that are most fundamental to effective aid.[5] The (2) corruption and (3) country ownership principles are emphasized while the other two principles of (1) macroeconomic stability and (4) institutional strength are more broadly assessed. If a model follows the development theory, which encourages country buy-in and overall country stability, it helps support long-term success of its programs and thus is effective.

Political Control: Just as over-politicization and "bureaucraticization" of domestic USG services hampers the effectiveness of their delivery, overwhelming political control of US foreign aid makes it less effective. Some level of political control, however, is mandatory in our system of government. Similarly, as far as US aid is a service to foreign citizens and not to foreign governments themselves, recipient countries should balance their own political control of aid so it is optimal for delivering services to their peoples.

Accountability & Results: These two self-explanatory elements are critical for assessing the effectiveness of any aid system. Both elements, however, are inherently challenging to measure given difficulty correlating aid's influence on recipient countries' policies. In particular, results face measurement error, insufficient data, and selection effects like political strategy and pressure—all of which may be more consequential than specific amounts of aid. Still, this study assumes some aid programs yield better results than

[4] These terms are borrowed directly from the 2005 Paris Declaration but are slightly differently and more broadly defined.

[5] One particularly important development principle excluded from this study is high levels of inequality (e.g. Gini over .45) make poverty reduction more difficult than lower levels of inequality (e.g. Gini lower than .45 but not much lower than .25). Development Theory criteria are determined by author. Some of theory analysis discusses trends shared by the entire US foreign aid system.

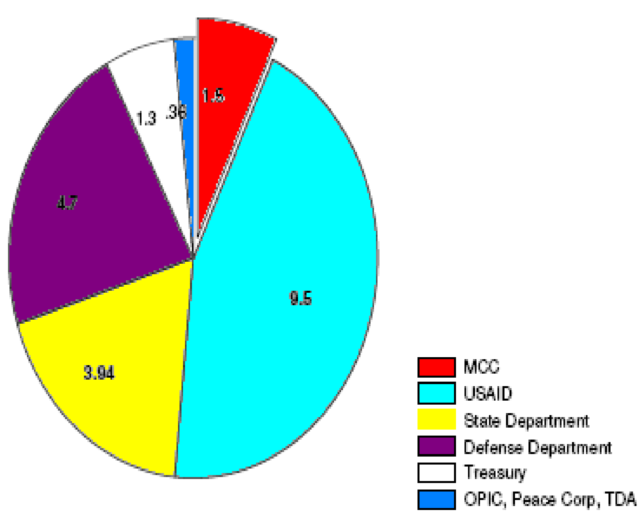
others, as some better measure up to missions/goals established by the distributing institution.

The Policy Problem in Context

Current structure of US foreign aid

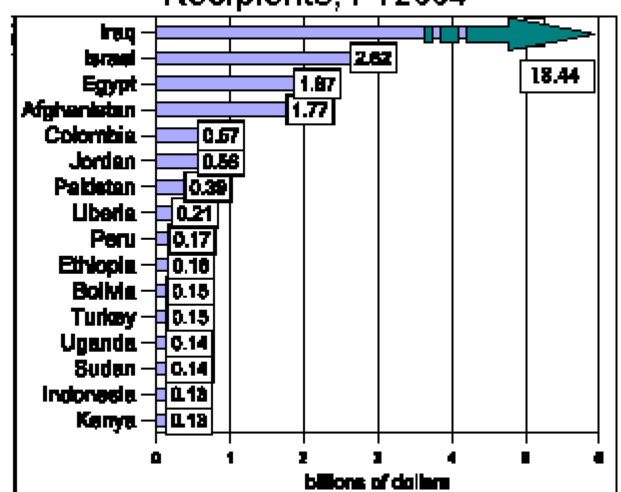
Given the complexity of appropriately measuring and categorizing US foreign aid, this section relies on aid categorization by the Congressional Research Service (CRS), the clearest and most reliable source for such statistics. (The rest of this study also uses these CRS figures, but also occasionally references different sources). The most recent CRS categorization uses fiscal year (FY) 2004 estimates, calculating the total FY 04 US foreign aid budget at $20.673 billion. The CRS distinguishes three major types of foreign aid: Bilateral development aid,[6] humanitarian aid,[7] and multilateral economic contributions[8] are all termed "development aid,"[9] and "military" and "economic/political/security" aid comprise the other two categories.

SOURCES OF U.S. FOREIGN AID (IN BILLIONS), 2004



Source: CRS Report for Congress, "Foreign Aid: An Introductory Overview of US Programs and Policy", http://usinfo.state.gov/usa/infousa/trade/files/98-916.pdf (color added by author)

Figure 4. Top Foreign Aid Recipients, FY2004



Source: CRS Report for Congress, "Foreign Aid: An Introductory Overview of US Programs and Policy"

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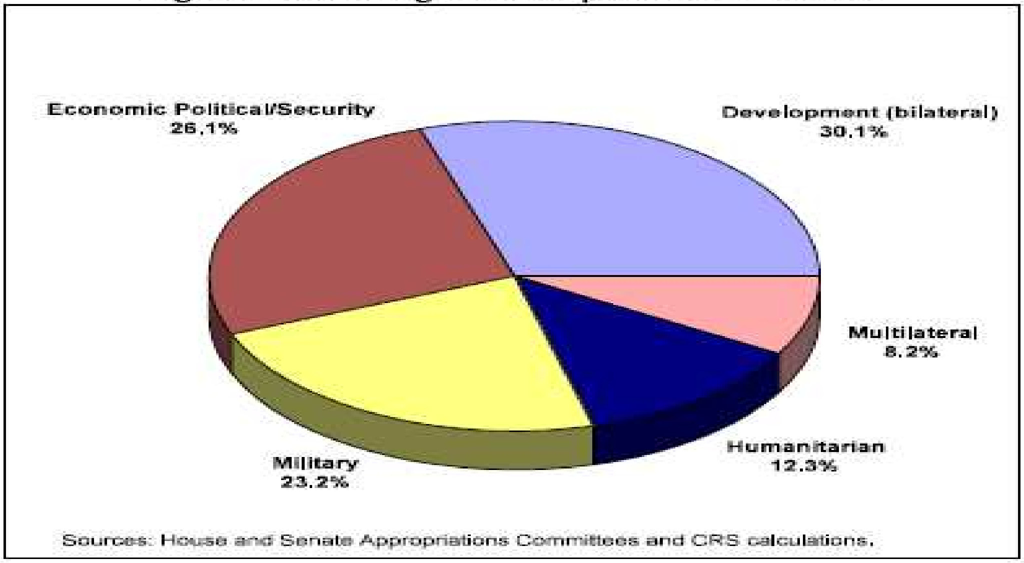
[6] Bilateral development aid is the largest source of US foreign aid, constituting 30% of aid, or $6.2 billion, in FY 2004. Bilateral development aid includes aid given to the African Development Foundation, MCC, Inter-American Development Foundation, Global AIDS Initiative, Peace Corps, and Trade and Development Agency.

[7] Humanitarian aid is allotted to the Office of US Foreign Disaster Assistance (OFDA), Office of Transition Initiatives (OTI), Title II food programs, and private voluntary organizations (PVOs).

[8] Multilateral economic contributions are largely administered by Treasury. UN agencies, notably UNICEF and the WFP, are major recipients of this aid. Multilateral development banks (MDBs) are also major recipients, as the US usually contributes about 20% of all MDB funds.

Figure 1. Aid Program Composition — FY2004



USAID

US foreign aid has traditionally had a strategic and ideological focus. In the aftermath of World War II, the US created a variety of aid agencies to reconstruct Europe via the Marshall Reconstruction Plan. Unfortunately, these agencies were a rather haphazard approach to long-term international development and reconstruction. In an effort to fix a broken system, the JFK administration passed the Foreign Assistance Act (FAA) in 1961. The FAA organized the USG's different development agencies—notably, the International Cooperation Agency (ICA), Development Loan Fund (DLF), Export-Import Bank, and Food for Peace Program (at USDA)—under one agency, USAID. Fitting with Cold War era mentality, USAID's mission was to "prevent the social injustice and economic chaos upon which subversion and revolt feed"—essentially to stop the spread of communism.

Between the 1970s and 1980s, several attempts were made to reform USAID. In 1971, the Senate rejected a foreign assistance bill for the first time, amidst growing concern that US foreign aid was being used unwisely in Vietnam and that USAID was evolving into a giveaway program. Consequentially, several amendments were added to the FAA in 1973, changing USAID from a money-doling institution to an agency where American expertise and consultation were central to aid operations. Throughout the 1980s, Congress made several efforts to reform USAID but failed to pass a comprehensive piece of reform legislation.

The 1990s were disastrous for USAID. As the Cold War ended, Congress began to question the necessity of a foreign aid agency. Foreign spending declined dramatically and there was even talk of getting rid of USAID all together. Finally, Congress decided USAID would continue operations, but under the condition it dramatically reduce capacity and adopt more private sector reforms. These reforms cost USAID 40% of its employees, as workers either left and were not replaced, or were laid off during the 1995 reduction in force (RIF). The loss of employees and pressure to adopt private sector reforms devastated the agency's human capital and forced a greater reliance on contracting.

After the attacks of September 11, 2001, the US foreign aid system changed. It began focusing more on the war on terror as the National Security Strategy (NSS) of 2002 listed aid as the "third pillar" of national security, supporting defense and diplomacy. In January 2006, Secretary of State Condoleezza Rice announced a major reengineering effort at USAID. Her reform created a new position, Director of Foreign Assistance (DFA), a new title for the Administrator of USAID carrying expanded responsibilities.

The 2006 restructure places the DFA under policy supervision from the Secretary of State. It also extends DFA oversight beyond development and assistance programs within USAID to all related programs at the State Department.[10] The new structure is intended to better align foreign assistance budgets and programs of State and USAID by consolidating and refocusing projects and staff. It is also intended to merge the mission of State and USAID, transitioning USAID from merely a development agency to an instrument of US foreign policy with a current mission to "create a more secure, democratic, and prosperous world for the benefit of the American people and the international community."

Aid programs under and outside direction of Director of Foreign Assistance

Under DFA direction ($15 bill. FY 06)	Outside DFA direction
All USAID accounts	African Development Foundation
Economic Support Fund	Inter-American Foundation
Foreign Military Financing	Office for Reconstruction & Stabilization (State)
FSA	Millennium Challenge Corporation
IMET	Peace Corps
Narcotics (INL) & ACI	PEPFAR (State)
Nonproliferation (NADR)	Treasury Dept. Debt Relief
Migration & Refugee Assistance	Treasury Dept. Technical Assistance
Peacekeeping Operations	
SEED	

IMET- International Military Education and Training
FSA – Assistance for the Independent States of the Former Soviet Union
PEPFAR – President's Emergency Plan for AIDS Relief
SEED – Assistance for Eastern Europe and Baltic States

Proposed reform for DFA-administered foreign assistance

Before resigning, former DFA Tobias proposed a Strategic Framework for State and USAID budget integration in FY 2008. The framework creates five categories of countries: 1) Rebuilding Countries—post-conflict states like Iraq and Haiti; 2) Transforming Countries—lower income countries (LICs) and lower-middle income countries (LMICs) eligible for the MCC; 3) Sustaining Partnership Countries—higher income countries the US has trade, economic, and security relationships with beyond aid; 4) Reforming Countries—authoritarian governments, a majority of which are ineligible

[10] The 2006 aid restructuring aligned budgets and missions of State and USAID but did not really alter foreign aid structure in other agencies, e.g. the Department of Agriculture, Commerce, Defense, Homeland Security, Justice, Labor, Treasury, Transportation, Health and Human Services, Interior, etc.

for assistance;[11] and 5) Developing countries—LICs and LMICs that have not yet met MCC criteria. This framework is intended to operate towards five objectives: governing justly and democratically, peace and security, economic growth, investing in people, and humanitarian assistance.

The MCC and MCA

The Millennium Challenge Corporation differs from the larger State and USAID foreign assistance institutions. The MCA was created as the US contribution towards the first Millennium Development Goal of reducing global poverty. Although announced by President Bush at the 2002 UN Conference on Financing for Development, the MCA/MCC was not enacted by Congress until 2004.

The Millennium Challenge Account is administrated by the Millennium Challenge Corporation, a government corporation. The MCC is not technically "run" by State and USAID, although it receives general oversight from both agencies' directors. The MCC is supervised by the Secretary of State, who serves as Chairman, as well as a Board of Directors: the DFA, the Secretary of the Treasury, the US Trade Representative (USTR), and four non-governmental directors recommended by House and Senate, nominated by the President, and confirmed by the Senate. The CEO of the MCC is nominated by the President. The current CEO, John Danilovich, replaced Paul Applegarth who resigned in mid-2005.[12]

The MCC's mission is to reduce poverty through sustainable economic growth in needy developing nations by assuring good governance and accountability. The MCC/MCA is the only existing mechanism for awarding aid solely on past performance, whereas other aid institutions like the World Bank and International Monetary Fund (IMF) award aid on ex ante conditionality. This makes the MCC/MCA a unique rewards program. On average, the MCC receives 7% of the overall foreign assistance budget, between 13-14 % of the combined MCC-USAID budget, and roughly 10% of the combined DFA-administered and MCC budget.[13]

Countries must first meet income eligibility criteria to qualify for MCC/MCA funds, which are delivered through the MCC's Threshold and Compact programs. Countries cannot be subject to any US or international sanctions if to be considered by the MCC.[14] Only LICs, who along with LMICs have income standards determined by the World Bank, were eligible for foreign assistance from FY 2004-2005. As of 2006, LMICs could qualify for MCC money, however, by law, only 25% of MCC/MCA Compact funds may be invested in Compacts for LMICs.

[11] NGOs are often relied upon to operate in these countries
[12] Applegarth resigned under fire for "not really being the right man for the job."
[13] Author's calculations, excluding DFA-administered funds, use CRS figures for FY 2004. DFA-administered funds calculation uses 2006 figures.
[14] US law prohibits USAID and MCC money from supporting government programs in Burma, Burundi, Cambodia, Central African Republic, Cote d'Ivoire, Cuba, Guinea Bissau, Liberia, Somalia, Sudan, Syria, Uzbekistan, and Zimbabwe.

Countries must go through several steps to qualify for Compacts. After first determining income eligibility, the MCC submits its selection criteria/methodology to Congress. This includes sixteen indicators, as well as any other criteria that may signal objectiveness to "reduce poverty and generate economic growth." Third, the MCC holds forums on its criteria/methodology open to public comment for 30 days. Fourth, the MCC selects eligible countries based on indicator scores to the "maximum extent possible." Countries are judged on three categories of indicators, and must score above the median on half of the indicators in each of the three categories. Also, it is mandatory that countries score above the median on the "control of corruption" indicator.

Income selection criteria

FY	**GNI/capita income eligibility for according FY**	**Final MCC Appropriation**
04	LIC: less, or = $1,415	$ 1 bill.
05	LIC: less, or = $1,435	$1.5 bill.
06	LIC: less, or = $1,575; LMIC: $1,575 - $3,255	$1.75 bill.
07	LIC: less, or = $1,673; LMIC: greater than $1,673 up to $3,465	$1.75 bill.

MCC/MCA Indicators

Indicator	**Sub-indicators**	**Indicator creator**
Ruling Justly	Civil Liberties	Freedom House
	Political Rights	Freedom House
	Voice and Accountability	World Bank
	Government Effectiveness	World Bank
	Rule of Law	World Bank
	Control of Corruption	World Bank
Investing in People	Public Expenditure on Health	WHO
	Immunization rate (DPT3 and measles)	WHO
	Girls' Primary Education Completion Rate	UNESCO
	Public Expenditure on Primary Education	UNESCO and national sources
Economic Freedom	Cost of Starting a Business	IFC
	Inflation rate	IMF WEO
	Days to start a business	IFC
	Trade policy	Heritage Foundation
	Regulatory quality	World Bank
	Fiscal Policy	National sources, IMF
Supplemental Information (Measured as of FY 07. Pending approval from the Board of Directors may be used as regular indicators starting FY 08.)	Natural resources management index	CIESIN/Yale
	Land rights and access index	IFAD/IFC

Countries are recommended for Compacts after they qualify for assistance. The MCC Board of Directors makes the final recommendation on Compact eligibility. Once recommended for a Compact, eligible counties are invited to submit a Compact Proposal to the MCC. Compacts must be created by the potential recipient country, incorporating insight from civil society groups, the public, private investors, and the government. If awarded a Compact, such groups will also oversee Compact implementation and establish accountability measures.

The MCC reviews proposals after a 15-day consultation period with Congress, and the MCC Board of Directors makes a decision on which countries receive Compacts. Compacts are then polished by the MCC and recipient countries and presented to the Board for final approval. Upon Board approval, Compacts are ready for signing. Compacts are presumably awarded according to requested proposal amount and scope of Compact. Compacts are limited to no more than five years.

Compact countries are assessed every year on income eligibility and indicator scores, and additional countries are usually added to the eligibility pool. In FY 2004, 16 countries were eligible for Compact funds; 17 in FY 2005 (16 from FY 04 + 1); 20 in FY 2006 (17 from FY 05 + 3); and 26 in FY 2007 (20 from FY 06 + 6). There are currently 11 countries with MCA Compacts.

The Threshold Program, another part of the MCC, is intended to help countries who show great improvement on many MCC indicators but have persistent problems on one or more indicators. As of FY 05, "threshold countries are countries that do not qualify for Millennium Challenge Account assistance but have demonstrated a commitment to meeting the eligibility requirements for MCA assistance in the future." Given similar parameters currently, the Threshold Program eligibility process is a bit more ambiguous than the Compact process.

Threshold agreements and Compacts share some basic structures. Both must meet the same income eligibility criteria. Like Compacts, Threshold contracts are presumably funded according to their size and scope. Also, there are currently 21 countries eligible for the Threshold program, 13 of which are currently receiving Threshold program contracts; these contract and eligibility ratios are similar to those of the Compact program.

After being selected as Threshold eligible, a country must submit a Threshold Country Plan. There are two phases of these plans, Section I and Section II. Section I requires a brief analysis of the MCC policy indicators in which the country fell short, what has been done to address these areas, and a commitment to reform. Section II requires a significantly more detailed plan. Both plans are reviewed by the MCC’s Investment Committee and its Board of Directors. Once the Board approves the plans, Congress is given a 15-day notification period after which contracts can be signed.

Threshold programs face several other stipulations. Unlike Compact agreements, Threshold Country Plans are implemented by USG agencies (e.g. most often USAID, DoJ, etc.). After being enrolled in the Threshold Program some countries may be eligible for Compacts. By law, the MCC can award no more than 10% of MCC funds to Threshold agreements.

Compacts as of 5/2007

Country	Date signed	Amount (millions)	Goal/Description
Madagascar	4/18/2005	$110	Help move to market-driven economy, develop agriculture and rural business
Honduras	6/13/2005	$215	Address low agricultural productivity and high transportation costs
Cape Verde	7/4/2005	$110	Increase agricultural productivity, integrate internal markets, reduce transportation costs, develop private sector
Nicaragua	7/14/2005	$175	Reduce transportation costs, improve access to markets, improve property rights, increase investment, raise incomes of farms and rural businesses
Georgia	9/12/2005	$295.3	Improve infrastructure, improve development of regional enterprises
Benin	2/22/2006	$307.3	Increase access to land and expand credit systems, bring courts closer to local populations
Vanuatu	3/2/2006	$65.69	Improve infrastructure
Armenia	3/27/2006	$235.65	Increase economic performance in the agricultural sector—reduce transportation costs, higher yield crops, etc.
Ghana	8/1/2006	$547.009	Increase production and productivity if high-value cash and food crops, enhance competitiveness of agricultural exports
Mali	11/13/2006	$406.8	Investment in infrastructure—namely the Bamako-Senou International Airport and Niger River irrigation system
El Salvador	11/29/2006	$461	Transportation projects, rural business development, investments in public services

Other eligible countries: Albania*, Burkina Faso*, Bolivia, East Timor (*), Jordan*, Lesotho, Moldova, Mongolia, Morocco, Mozambique, Namibia, Senegal, Sri Lanka, Ukraine*, and Tanzania*. Eligible countries that currently have not entered Compacts ostensibly are awaiting funding or still have yet to submit a finalized/agreeable proposal to the MCC. * denotes country is already receiving Threshold funds. (*) denotes country is not receiving funds but is eligible for both the Compact and Threshold program.

Threshold Programs as of 5/2007

Country	Date signed	Amount (millions)	Goal/description
Burkina Faso	7/22/05	$12.9	Improve girls primary education completion rates
Malawi	9/23/05	$21	Reduce corruption and improve fiscal management
Albania	4/3/2006	$13.85	Reduce corruption
Tanzania	5/3/2006	$11	Reduce corruption
Paraguay	5/8/06	$34.65	Fight corruption and improve business climate

Zambia	5/22/06	$22.7	Reduce corruption and improve government effectiveness
Philippines	7/26/06	$21	Fight corruption and improve revenue collection
Jordan	10/17/06	$25	Strengthen democratic institutions
Indonesia	11/17/06	$55	Improve childhood immunization and curb corruption
Ukraine	10/4/06	$45	Fight corruption
Moldova	12/15/06	$24.7	Support anti-corruption initiatives
Kenya	3/23/07	$12.70	Reduce corruption
Uganda	3/29/07	$10.40	Reduce corruption

Other eligible countries: Yemen (reinstated in 2007), East Timor, Guyana, Kyrgyz Republic, Niger, Peru, Rwanda, and Sao Tome and Principe. Eligible countries that currently have not entered Threshold Program Plans ostensibly are awaiting funding or still have yet to submit a finalized/agreeable proposal to the MCC.

Analysis, Including Options

MODEL A: USAID PRE-MCC

Some might argue the pre-MCC model of US foreign assistance is the most effective aid system. Using Model A, which measures aid effectiveness at USAID pre-MCC, we assess this argument. Although different time periods within Model A might present issues of slightly different substance, the model still shows the broad ineffectiveness of the USAID system pre-MCC. The model does not meet the aid effectiveness criteria given its overlapping programs, uncompetitive sourcing, incongruence with development theory, congressional earmarking, lack of accountability, and mixed results in meeting program goals.

Alignment/Harmonization

The pre-MCC USAID aid distribution system does not have an adequately efficient or effective procurement or financial management & coordination process. Specifically, Model A's alignment/harmonization of aid is ineffective because of overlapping of projects, lack of competitive sourcing, and restrictive laws.

USAID and State programs have traditionally overlapped. One reason for such poor coordination is the classic trend that US agencies, e.g. USAID, State, DoD, DoA, etc. all like to maintain high-profile and publicly-attractive programs, regardless if another agency has a similar program or is better suited to implement such a program. A complicated system of overlapping projects and project goals makes the pre-MCC model very ineffective at aligning and harmonizing aid.

The President's Management Agenda (PMA) scorecard, a management assessment first developed in 2001 to grade executive agencies, has consistently issued [US]AID a "red" score for competitive sourcing, indicating "unsatisfactory" performance. Additionally, during the pre-MCC years, 2001-December 2003, USAID showed no sign of "successful" improvement (a "green" score) in competitive sourcing. Although the scorecard only measures a small snapshot of USAID's pre-MCC history it is representative of an alignment/harmonization problem that has long plagued USAID. The magnitude of this uncompetitive sourcing problem became most pronounced after the dramatic USAID workforce reductions of the 1990s, and subsequently a handful of D.C.-based contractors engrained themselves in USAID contracting culture.

A lack of competitiveness in sourcing makes Model A's alignment/harmonization of aid ineffective by unwisely denying contracts to qualified American and foreign firms. Program oversight and implementation usually costs less for foreign firms in countries of aid operations than for outside contractors, who must hire Foreign Service nationals (FSNs) and other personnel.[15] Model A also deprives qualified foreign firms of revenue, simultaneously depriving the economy in the country of operation.

Laws are a significant contributor to the pre-MCC aid system's poor score on the alignment/harmonization criterion. The FAA extends guidelines of the Buy-American Act (1933) to USAID programs. The Buy-American Act, standard across government, requires agencies purchase most of their goods/products within the US. This creates "tied" aid. USAID usually must use American goods for foods or services, although it can buy many products from Africa when in Africa. Some exceptions are made on a case-by-case basis. Federal Acquisition regulations laws allow the USAID Administrator to waive normal contracting procedures via written determination that "compliance with full and open competition procedures would impair foreign assistance objectives and would be inconsistent with the fulfillment of foreign assistance programs." [16] The effect of this loophole on alignment/harmonization is dubious.

In fairness, some units in the pre-MCC system have more efficient and effective alignment procedures than the larger system, largely because of the specificity of their mission. One such unit is the Office of Transition Initiatives (OTI), created in 1994 as a fast and flexible unit for providing short-term aid supporting democratic change; OTI's use of the Support Which Implements Fast Transition (SWIFT) mechanism speeds contracting. Although OTI and several other units have special contracting mechanisms, they are not representative of the overall inefficient alignment practices within the larger pre-MCC USAID model.[17]

On average, it takes between 18-24 months to graduate from proposal to contract under most multilateral and bilateral aid programs.[18] This slow process contributes to Model A's poor score on the alignment/harmonization criteria. The majority of Model A's projects usually require extensive documentation of expected outcomes, cultural impact, effect on women or vulnerable groups, risk, etc.—even projects for disasters and emergency require a standard pre-assessment.

[15] Assuming there are capable and established firms already in countries of operation, which is not always the case

[16] Recall Model A is pre-MCC, and the "Administrator" title was not changed to "DFA" until 2006

[17] Other units include the US Office of Foreign Disaster Assistance (OFDA)

[18] Fox, James and Lex Rieffel. *The Millennium Challenge Account: Moving Toward Smarter Aid."* The Brookings Institution, Washington D.C: July 2005. 1-38.

Development Theory

The pre-MCC model earns mixed results on three of the four development theory principles and outright violates one. Accordingly, the model does not clearly meet the development theory criteria.

The pre-MCC model outright ignores the second (2) development theory criterion that corruption tends to make economies less efficient. In fact, 2002 study by Alesina and Weder entitled *Do Corrupt Governments Receive Less Foreign Aid?* finds a positive correlation between corruption and US aid. In other words, the majority of US foreign aid as of 2002 (pre-MCC) went to less than efficient economies and governments.[19]

Model A presents mixed results on development criterion (1) macroeconomic stability and (4) institutional strength. A seminal 2000 study by Burnside and Dollar finds a weak association between international aid flows and policy. This in part reflects the pre-MCC model's weak adherence to the macroeconomic stability criterion. As for criterion (4), there is little evidence aid within Model A is awarded to countries with the most viable and effective institutions, although there is a trend of awarding non-communist institutions.

Perhaps one of the biggest weaknesses of the pre-MCC aid system is its mixed results on the third development theory criterion (3), country ownership. Pre-MCC programs are usually run from the top-down, where ambassadors and government officials determine types and monetary values of aid projects. In this sense, there is some vested interest in the success of aid projects but it is by no means widespread across the larger population of the recipient country, or even within the US for that matter. Without country ownership there is often not enough incentive or vested interest for a recipient country to fully commit to optimizing aid.

The pre-MCC system faces significant cultural barriers in aid implementation because it does not encourage enough country ownership. Take the anecdotal example that several years ago, USAID staff working on a tight schedule arrived in a Middle Eastern country to install financial software systems and implement a few other projects—the group did not realize it was Ramadan and they could not work during the holiday. In similar situations, USAID has discovered labor mobility inhibited by culture, e.g. women involved in aid projects can not relocate, even temporarily, without taking their families with them. Such examples are representative of the larger and well-documented phenomenon of cultural unawareness US aid institutions face when entering a foreign region or country, especially those with non-Western cultures.

[19] This trend is inclusive of the entire pre-MCC US foreign aid system, not exclusively USAID.

Political Control

Congressional earmarks make the pre-MCC system model ineffective. Congress earmarks USG funding for most foreign assistance, only allowing spending in designated sectors. Congressional earmarks are usually very limited compared with the magnitude of congressionally-mandated and USAID-administered program demands.

Andrew Natsios, USAID Administrator during the pre-MCC era, identified congressional earmarking of aid as a "greater problem than USAID's deficiencies in program and mission coordination." Since the late 1960s and 1970s, Congress has been worried about giving USAID too much discretion over its own budget, one reason being USAID has had trouble showing transparency in its budgeting practices, another being it has shown inconsistent project results. Political control in Model A herein is a circular problem.

Accountability

Internal obstacles in Model A complicate accountability between USAID and Congress, and between USAID and its aid recipients. Model A lacks an appropriate reporting framework for measuring progress, although in fairness, establishing such a system is difficult given the inherent lag in performance results associated with long-term aid projects.

The pre-MCC system does have some mechanisms for standardizing its financial and management accountabilities, but still adheres to an inappropriate combination of weak bottom-up accountability and over-burdening top-down accountability. This is a traditional problem in Model A: top management feels pressure from Congress and the Executive, and in response implements often inappropriate outcome/performance standards throughout the agency which are applicable all the way to ground operations. This approach largely ignores ground-level operation autonomy and imposes indicators that are not well-tailored to particular ground situations and environments.

Results

Actual results are the most ambiguous issue in the effectiveness of aid debate. Without delving into an exhaustive analysis—which would inevitably become quite subjective—we can recognize there have been some positive (at least marginally), negative, and rather non-consequential results of aid in Model A. Still, even lines between these results are often subjective.

Model A's track record for meeting aid agency goals is mixed. For one, US aid's record for helping countries develop and alleviate destruction wrought by natural disasters and complex emergencies is mixed. Some have argued Model A yields results in-line with its top mission to prevent the spread of communism. Still, the extent to which US aid directly contributed to this result rather than the failing of communism for a variety of other reasons, and the extent to which aid efficiently supported this result, is dubious in many instances.

After September 11th, but still pre-MCC, the aid system was revamped to help combat global terrorism. It may be too early for a comprehensive analysis on aid's contribution to this recent endeavor. One may conclude, measuring the results of aid given to South Asian states like Pakistan, and Middle Eastern states like Egypt, Jordan, Israel, and Saudi Arabia, that aid has had a positive effect on reducing terrorism.[20] Still, this trend is debatable, and recently is even starting to look more negligible than positive.

MODEL B: STATUS QUO, DFA-ADMINISTERED AND MCC AID

Model B suffers from many of the pre-MCC failures discussed in Model A. Given Model A's discussion of the broad USAID aid system, this analysis will primarily highlight the MCC. According to our analysis, the MCC's ability to avoid complex procurement processes, quickly write and sign Compacts, award aid to demonstrated good performance and largely avoid restrictions in the congressional earmarking process make it more effective than the pre-MCC model/Model A. Despite these effective characteristics, however, the status-quo model is still largely ineffective because the MCC only compromises around 7% of overall foreign aid, and roughly 10% of combined DFA-administered and MCC aid.

Alignment/Harmonization

Given inherent lags in nearly all development programs, institutions like the MCC that reduce bureaucratic processing are optimal for alignment/harmonization of aid. The MCC also wisely extends eligibility to a majority of the poorest LICs, although there is concern about what percentage of LMICs are receiving funds. Despite positive performance on the alignment/harmonization criterion, however, the MCC/MCA is only a limited part of the status quo foreign assistance system, and so its successes alone cannot justify leaving the current aid system at status quo.

Procurement for MCC programs is much faster/more efficient than most all bilateral and multilateral aid programs. This allows the MCC to operate fairly smoothly and largely avoid the issues of uncompetitive sourcing in Model A. In particular, the MCC is not required to follow the same tied aid rules of Model A.

The process of project enactment is much faster for the MCA than for other aid programs. On average, MCA programs usually take around 6 months for contracts to graduate from proposal to implementation. In contrast, recall most bilateral and multilateral aid projects usually take 18-24 months.

The timeliness of MCA programs is partially due to laxer procurement rules. Also, Compacts are arranged quicker because unlike other aid plans they do not require extensive documentation of expected outcomes, cultural impact, effect on women or vulnerable groups, risk, etc. This is not necessarily a dangerous trade-off because MCC

[20] "Results" might include number of international terrorist attacks on the US thwarted, number of international terrorists killed, etc.

countries are required to develop their own solid strategies for contracts, as discussed in the next section.

There should be natural concerns about alignment/harmonization of MCC aid. Although the MCC funds countries that score well on indicator scores, what about countries that have little hope of meeting indicator goals in the near term? After all, it might seem that the best performing countries—those that essentially have ‘well’ organized and properly running governments and economies—may not be the poorest and/or are least in need of outside assistance.

The above idea has some merit, but the MCC awards the majority of its Compact funds (75%) to LICs as required by law. In fact, among all eligible LICs, the MCC has contracts or extends eligibility to 53% of the countries in the bottom income quartile, 60% of those in the second lowest quartile, 60% in the third quartile, and 53% in the highest quartile.[21] Accordingly, the MCC is inclusive of a respectable amount of even the poorest LICs.

Although a majority of the poorest LICs are eligible for the MCC funding, LMICs make up a significant percentage of countries actually receiving funding.[22] This is potentially detrimental to aid alignment/harmonization focusing on the MCC’s core mission. LMICs make up 36% of countries currently funded by Compact agreements and 23% of countries with funded Threshold plans. Overall, LMICs make up 29% of countries with both Compacts and Threshold agreements. Although LMICS are not receiving over 25% of MCC Compact funding, which would violate MCC regulations, if they continue to make up a significant portion of funded MCC/MCA programs while LICs stay ‘in the pipeline’ waiting to receive funding this may be cause for concern (see Appendix-Figure C).

Development Theory

The MCC meets the development theory criteria, although its performance on criteria (3) and (4) is a somewhat debatable. Additionally, evidence suggests it would be very difficult for countries to “game” the MCC system—fudging indicator scores—as some indictors are too opaque to manipulate, and outside experts use indicator rating schemes to which countries are not fully privy. Unfortunately, the MCA/MCC is only a limited part of the status quo foreign assistance system, and so its successes in development theory alone cannot justify leaving the current aid system at status quo.

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[21] Estimates by author for all MCA programs using MCC countries eligible as of FY 2007 and the most recent WB categorization available (used in 2007), which uses GNI/capita from 2005. Somalia, Cuba, and Myanmar excluded because not specifically ranked in the WB categorization. MCC 2005 LIC income cut-off of $1,435 was used, but Angola (the highest income LIC country) was excluded to make quartile sums round numbers. Syria, Cote d’Ivoire, Sudan, Uzbekistan, Central African Republic, Zimbabwe, Guinea-Bissau, Liberia, and Burundi were also excluded because of laws prohibiting their receipt of direct US foreign assistance.

[22] Estimates by author using MCC countries eligible as of FY 2007 and the most recent WB categorization available (used in 2007), which uses GNI/capita from 2005. Somalia, Cuba, and Myanmar excluded because not specifically ranked in the WB categorization. MCC 2005 LIC income cut-off of $1,435 used.

Awarding good scores on MCC indicators is a fairly substantive way to meet development principle (1), and arguably principle (4). Using indicators on "Economic Freedom" to rank countries helps ensure macroeconomic stability, at very least because these indicators are currently the best measures for macro policy available. Due to the comprehensiveness of all MCC indicators, one could assume eligible MCC countries need fairly well-established institutions—or at least institutions comparatively better than those with significantly worse indicator scores—to appropriately meet the eligibility level required of them. This assumption, however, may be debatable and in fact incorrect, presenting a number of issues for the MCA/MCC, as well as development studies at large, which are discussed in the Appendix-Figure A.[23]

The MCC/MCA attempts to create a public opinion mechanism not as visible in the larger current foreign assistance system, bringing the MCC at least partially in-line with the (3) country ownership principle. Some suggest MCC countries are able to meet the country ownership principle because many are required to submit Poverty Reduction Strategy Papers (PRSPs) to the World Bank and IMF.[24] Although PRSPs may provide an unprecedented mechanism for some level of "country ownership" in aid programs, the degree of their effectiveness as a "democratic" participation mechanism is disputed.

PRSP weaknesses may foreshadow potential weaknesses in many MCC country-ownership practices. Further, given the economic slant of the MCC's policy indicators, it would not be surprising if private sector investors and consultants within a country overwhelmingly dominate, and perhaps manipulate, the MCA Compact and Threshold proposal process. Fully evaluating this issue is a good topic for another study.

MCC Compact and Threshold Countries & PRSPs

LICs w/PRSPS				**LICs w/out PRSPs**	**LMICs w/ PRSPs**	**LMICs w/out PRSPs**
Madagascar Honduras Nicaragua Georgia Benin Ghana Mali	Bolivia East Timor Burkina Faso Lesotho Moldova Mongolia Mozambique	Senegal Sri Lanka Tanzania Malawi* Zambia* Kenya* Uganda*	Guyana* Kyrgyz Republic* Niger* Rwanda* Sao Tome and Principe*	Paraguay* Philippines* Jordan Indonesia*	Armenia Vanuatu Albania Cape Verde	El Salvador Morocco Namibia Ukraine Jordan Peru*

* denotes exclusively Threshold countries. FY 05 income standards used. PRSP status as of 2007.

[23] Note: referring to the Appendix – Figur*e B*, institutional strength (with a positive coefficient) held a statistically significant relationship with the amount of money awarded to Threshold Programs.
[24] PRSPs are annual progress reports discussing a country's macro, social, and structural polices for growth, poverty reduction, and economic stability. They are updated every three years, and serve as the basis for Highly Indebted Poor Country (HIPC) participation and International Development Association (IDA) assistance.

Political Control

The MCC generally avoids the restrictive congressional earmarking of the pre-MCC system. Still, as a government corporation, the MCC is not immune to all political pressure.[25] Further, the MCC is only a limited part of the status quo model and so the larger model still faces the same restrictive political control of the pre-MCC model.

Congress flatly approves the MCC's gross budget. The MCC is given discretion on how to spend this money, avoiding much of the "politics of aid" traditionally burdening USAID in Model A. It is important to note, however, that one reason Congress has yet to approve the full request for MCA funds in any fiscal year is at least partly because the budget is limited by Iraq, Afghanistan, and other war on terror expenditures.

Some may assume the MCC is simply an extension of the most recent US foreign policy drive to heavily award democracies since it awards good governance as defined by institutions often associated with Western ideologies. MCC funds, however, are not necessarily only awarded to established democracies. Uganda, an autocracy, currently receives Threshold Program funds to reduce corruption. Jordan, which is not a democracy, receives Threshold funds, albeit funds to build democratic institutions. Rwanda and Morocco are also eligible for MCC money, yet neither are democracies.

Although there is strong evidence indicating countries are awarded contracts because of their superlative scores on MCC indicators, there is some question about exactly which countries are ultimately selected for eligibility—as sometimes otherwise "eligible" countries are not invited by the MCC Board of Directors to apply to the program. This may suggest some political finagling within the program. For example, Bulgaria, Brazil, and Samoa scored among eligible countries during FY 2007 but were not invited into the Compact program. Still, most evidence suggests the Compact program is far less political than other US aid programs.

The MCC's Threshold Program faces slightly different political involvement than the Compact program, which may ultimately affect its politicization. Recall that after the MCC Board of Directors approves Threshold plans Congress is given a 15-day notification period *after which* the agreement can be signed. Compacts, however, require a 15-day consultation period with Congress *before* the Board makes the final decision on funding; Compacts are exclusively presented to the Board for approval before being signed. Although it is unclear how exactly the approval process affects the Threshold program, it may potentially politicize it more than the Compact program.

[25] Additionally, the MCC shares several restrictions on program expenditures and processes with other US foreign aid programs that may or may not be appropriately termed "political." US law prohibits USAID and MCC money from supporting government programs in Burma, Burundi, Cambodia, Central African Republic, Cote d'Ivoire, Cuba, Guinea Bissau, Liberia, Somalia, Sudan, Syria, Uzbekistan, and Zimbabwe. Also, the MCC and USAID must notify Congress at least fourteen days prior to any proposed project commitments. Additionally, no aid programs can use USG funds for abortions and sterilizations.

There is also ambiguity surrounding Threshold country eligibility. There is evidence that Secretary Rice wanted Jordan to be a Threshold country and so pushed it in front of other candidate countries with similar indicator scores. The Kyrgyz Republic, which failed all of the "Ruling Justly" indicators in 2006, was still invited into the Threshold Program. Indonesia, invited into the Threshold Program in 2006, has consistently fallen substantially short on many policy indicators.

Although uncertainty surrounds Compact and Threshold country selection, which may very well involve some political motivations, allotment of funds to eligible countries is likely independent of overt political motivations. Funding is also likely independent of relative income.[26] A regression model for Threshold Program contracts suggests that GNI/capita, population, as well as a variety of 'political' variables—e.g. percentage of Muslims in the country, status as a terrorist haven, number of visits by the Secretary of State, percent of exports to the US, etc.—were not statistically significant determinants of the amount of money awarded to Threshold countries (See Appendix - Figure B). This may suggest Threshold Program monies are awarded more by proposal merit than by political considerations. Also, since Compact program selection is potentially less political than Threshold program selection, one might speculate that awarding of funds for the former is no more political than for the latter.

Accountability

The MCA has several good accountability measures, including its mechanism for awarding funding, bottom-up accountability standards, and willingness to punish countries that do not maintain good indicator scores. Still, there are some ambiguities surrounding MCA accountability mechanisms. Also, although USAID has made some reforms during the MCC years, notably adding the Performance and Accountability Report (PAR) it jointly files with State, some say these changes reflect the same largely misguided approach towards accountability present in the pre-MCC model. Further, the MCC only makes up a limited amount of the status quo system, and so despite its contribution to improved accountability practices, its impact on Model B's effectiveness is limited.

The MCC has the unique mechanism of awarding funding after progress has been made rather than ex ante. This seems to be one of the most promising mechanisms for aid accountability. Also, given adherence to the country ownership principle, MCA countries in Model B have a greater flexibility in creating bottom-up accountability measures in coordination with the MCC, avoiding the top-down approach that perverted Model A's accountability.

The MCC has demonstrated willingness to punish Threshold countries who do not maintain appropriate scores on policy indicators. This sort of solid accountability is largely unfathomable at USAID, after all "what might the ambassador say?" In June 2006, The Gambia was suspended from Compact eligibility due to actions inconsistent

[26] This trend is not necessarily worrisome as it does not measure purchasing power parity (PPP)-adjusted income. Even if it used PPP adjusted income the trend is not necessarily negative.

with selection criteria. Within the last year, a stop-order was placed on the MCC contract with Paraguay until it successfully filed a "remediation plan" to tackle worsening corruption. In 2005, Yemen was dropped from the Threshold Program, and only after arguably 'learning its lesson' via improvement in several MCC indicators was it reinstated in 2007.[27]

Although it demonstrates willingness to punish Threshold countries, the MCC faces challenges from Compact countries backsliding on their indicator scores. It is inferably easier to suspend and terminate agreements under the Threshold Program than under the Compact Program. Recall that the Threshold Program relies on USG contracts, whereas Compacts are instead contracts between the MCC and the recipient's country's national government. This may complicate the MCC's accountability measures, as illustrated by Armenia, a Compact country that has notably regressed in the area of democratic governance but has not yet had its Compact status effectively jeopardized, suspended, or terminated.

Results

Although the MCC mechanism is likely the best available US aid system for encouraging economic growth, it has not *yet* yielded solid results in either increasing economic growth or reducing poverty. Additionally, and as mentioned, the MCA/MCC is only a very limited part of the status quo foreign assistance system, so its potential successes cannot justify leaving the current aid system at status quo.

Basing awards on indicators is not a new US aid method to award a country's economic performance. As implemented by the MCC, however, it may be one of the more effective methods—creating what has become known as the "MCC effect."[28] According to a 2006 Harvard University study using difference-in-difference modeling, potential recipients of MCC monies improved 25% more on indicators after the MCC was created than before its creation. [29]

While the MCC has set up a system that rewards the 'most capable' national governments, there is no strong quantitative evidence suggesting it has created economic growth, which is its central mission. There is also no strong quantitative evidence that it has contributed to poverty reduction. Lack of results may be due to time lags, especially since the MCC/MCA is less than four years old. The effectiveness of MCC/MCA in creating economic growth will undoubtedly be closely monitored in the near future.

[27] Still, Yemen fails 13 of the 16 indicators

[28] Several phenomena are similar to the MCC effect, albeit not from "aid" programs per say: A) The WTO requires countries to meet a variety of policy indicators before gaining membership. According to seminal analysis by Tang and Wei (2006), the *process* of reforming to qualify for the WTO afforded countries their highest growth rates, although they experienced only modest increases in growth subsequent to induction into the organization. MCA countries may or may not fully follow this pattern. B) Countries must show a certain level of competency on 35 policy indicators before joining the EU.

[29] Johnson, Doug and Tristan Zajonc. *Can Foreign Aid Create an Incentive for Good Governance? Evidence from the Millennium Challenge Corporation*. Harvard University, 2006.

MODEL C: CHANNELING MORE AID THROUGH THE MCC/MCA

Model C simply requires the MCC receive a larger proportion of the foreign aid budget, without changing the structure of the existing MCC system. The model would not require an increase in overall foreign aid because the MCC/MCA system is already in place. Any cost would simply be hiring new MCC staff to take on the increased workload and manage the increased funds—and this overhead would be largely offset since MCC staff could replace USAID staff and USAID employees could transfer to the MCC. To truly make Model C analysis-worthy it will increase the MCC's percentage of the overall US foreign assistance budget by 200%. This would require channeling 20% of DFA-administered funds into the MCC.

Since the MCC/MCA itself is an effective aid distributing institution, it might seem rational to assume expanding it on a larger level would only more widely spread its benefits. This, however, is an invalid assumption. Although the MCC works for itself as currently structured, there are potential problems when simply expanding it as a larger foreign aid model.

Alignment/Harmonization

When expanded, the MCC system faces several alignment/harmonization challenges not necessarily shared by the current MCC system. Model C's restrictions on duration and number of Compacts are problematic. The model also potentially diverts funds from the development assistance (DA) account and may jeopardize sector-specific aid programs.

The MCC faces restrictions on the duration and number of Compacts it can operate at a given time, and so may not be an optimal model for larger foreign assistance reform, although these restrictions seem to make sense for the current MCC system. MCC Compacts are limited to five years like most World Bank projects. This limit may make sense for the sake of predictable results, but may unnecessarily limit development in some countries that would be better suited with more time to implement projects. Also, MCC rules prohibit it from entering multiple Compacts with any individual country. These restrictions should not apply to a larger foreign assistance system model because they pose tight limits on development plans.

A study by the Center for Global Development finds recent US aid has been reduced to all countries, excluding outlier countries of Iraq, Afghanistan, Jordan, and Pakistan.[30] Of these cuts, cuts to MCA countries are largely from the USAID-appropriated development assistance (DA) account. It is unclear why funds are reduced in the DA account, but this is an alarming pattern. Model C does little to protect its funds in this environment.

Simply expanding the MCC threatens effective alignment/harmonization of aid because it might divert funds from programs US agencies might otherwise fund. Recall the MCC does not require countries to spend money in specific sectors, but rather lets them decide

[30] Brown, Kaysie, and Bilal Siddiqi, and Myra Sessions. *US Development Aid and the Millennium Challenge Account: Emerging Trends in Appropriations*. Center for Global Development. Oct. 2006.

what projects they would like the MCC to fund. This mechanism may end up creating a development gap. Although Model C expands the allocation of MCC money it does not stipulate that eligible countries must keep their funding from other DA programs. For example, if Benin receives MCC funds to build its agricultural sector, USAID development assistance that would otherwise go to developing its educational sector might now be awarded to a different country that does not receive MCC funds.

Development Theory

Expanding the MCC's percentage of the foreign aid budget will probably magnify the effectiveness of Model B in terms of development principles (1), (2), and (4). However, although analysis suggests the MCC at least partially meets the development criterion (3) country ownership (see Model B), it may also unnecessarily define and limit country ownership since it requires Compacts to be signed exclusively with national governments. This stipulation seems acceptable for the current MCC system but limits the applicability of the model on a larger scale. In fact, Judith Tenler in her book *Good Government in the Tropics* suggests that many development programs, including corruption-busting, are best implemented by *state* government, via Industrial Performance and Workforce Transformation (IPWT), one model for country-ownership.

Political Control

Driving more aid through a MCC-style mechanism may partially alleviate the inefficiencies the current system faces in congressional earmarking. The expansion, however, will inevitably affect non-emergency spending aid doled out each year in the Foreign Operations budget, which determines the majority of funds for USG aid programs. Herein, the degree to which Model C forces politicians to prioritize what programs they must cut or adjust in order to award the MCC a larger percentage of foreign aid will determine the political feasibility of Model C.

Politicians may fight Model C to the extent that it forces cuts in politically attractive programs that do not fit under the MCC's framework, i.e. aid to countries that do not qualify under the MCC's selection methods. There are countries in humanitarian, economic/political/security, and particularly high-profile programs like the President's Emergency Plan for AIDS Relief (PEPFAR) that might be denied aid under Model C. This puts politicians in a difficult position.

Model C might force Congress to reduce military aid to three of the five top recipients of US military aid (see Appendix - Figure D). This would cause great political concern. Current MCC income eligibility requirements are too low to be applicable Israel, the consistent number one recipient of US military foreign assistance. Additionally, two other of the top recipients of US military aid, Colombia and Pakistan, do not meet the MCC eligibility criteria, failing to score above the median on at least half of the indicators per the three major policy areas.

Accountability

Model C would inferably experience roughly the same types of accountability strengths and weaknesses of Model B.

Results

We can only forecast the results of Model C. Given the analysis of the other criteria in the model we assume results would be as mixed or maybe slightly better than in Model B.

Recommendations – Creating Model D

The US aid system should be reformed along Model D to develop the positive and avoid the negative qualities of models A, B, and C. Model D should be well-funded. It will look closest to Model C in that it allots an increased percentage of the US foreign aid budget to the MCC. Model D also adds two new indicators to the current sixteen and makes some minor changes to current MCC Compact and Threshold structure and regulations.

Model D allots 20-25% of DFA-administered funds to the MCC/MCA. The model only modestly increases funding for the Compact program using 7-8% of these DFA-administered funds, a sum almost in-line with the President's recent yearly budget requests for the MCC/MCA as a whole. The additional 15-17% of funding is for the Threshold Program and a new program called Threshold Gold, a proposal that will require a change in current law limiting the Threshold program to 10% of MCC funds.

MCC, USAID, and State staff should decide how the two Threshold programs should best divide the new funding. Any unused funds can be carried over from year to year with no expiration date, keeping in-line with current MCC funding structure. A mechanism for redistributing MCC funds to different US agencies or aid plans under discretion of the DFA and MCC CEO might be created.

The Threshold Gold Program is modeled after the current Threshold Program, with some amendments. Threshold Gold programs should implement contracts primarily with state and/or regional governments in countries that reflect solid progress in indicators/selection criteria. USG agency assistance should be limited in these countries, and used only in areas where recipient governments prove they cannot implement projects on their own.

Threshold Gold has the same approval structure as Compacts, unless a strong case is otherwise made for adopting the Threshold Program structure. For feasibility, a separate Board of Directors—which will most likely include many if not all of the same agency directors currently on the MCC Board—for Compacts and the Threshold/Threshold Gold programs may need to be established.

In Model D, clearer description of exactly what indicator scores and criteria are needed to qualify for Threshold program(s), even if it is a range, is written into MCC regulations. This may require adding different indicators, and/or removing indicators currently on the MCC Compact list. Standard performance on these indicators is required to qualify for

Threshold and Threshold Gold programs. These reforms should limit politicization of the Threshold program. The Threshold program is currently one of the best systems to award 'improving' countries, and these reforms further support Model D's option of allotting it more funding. Countries that do not pass indicators should be referred to other aid programs at USAID or other agencies.

Model D also adds a specific set of indicators/criteria specifically for the Threshold Gold program. These criteria should better fit state and regional governance and economic management, as failure on certain current indicators, e.g. macro indicators, may unnecessarily cause the MCC to overlook benevolent state and regional governments within a country that has a corrupt and/or ineffective national government.

Model D proposes several other changes to current MCC/MCA system. It allows some Compacts to extend anywhere from six-ten years, which will create a better boundary of timeliness for some projects. It also allows multiple Compact agreements with individual countries, although there should be some restrictions on this practice. Also, the model provides a 'Development Assistance Assurance Clause,' preferably written into law, providing assurance to eligible countries that their DA funds will not be completely sacrificed because they are enrolled in a MCC/MCA program. To strengthen Compact accountability, Model D requires the MCC develop a clear criteria for penalizing, terminating, and/or reinstalling countries.

Model D also adds two new indicators to the current MCC/MCA system. First, it adds an indicator for "inequality." Such an indicator could use the Gini coefficient, Theil coefficient, a hybrid of the two, or another appropriate inequality gauge. There is substantial evidence to suggest that high levels of inequality complicate and slow poverty reduction. Second, a "disaster preparedness" indicator is added to the current system. This indicator might measure the amount of money used for, and quality of, a country's Emergency/Early Warning System(s) (EWS) for disasters. Countries in disaster prone regions, e.g. the Sahel region in Africa, might be more critically evaluated on this indicator, as lack of disaster preparedness can cause years of aid to essentially go to waste in a matter of days. The MCC should work with the US Office of Foreign Disaster Assistance (OFDA) on the logistics of this disaster preparedness indicator.

The MCC may want to consider a few issues before building the Model D framework. It should review former-DFA Tobias' FY 08 proposal for five categories of aid with the current DFA. It may want to commission a study on the institutional quality question of Model B and Appendix - Figure A. Also, the MCC may want to commission a study on the 'in the pipeline' issue of LMICs currently receiving MCA funding discussed in Model B and Appendix – Figure C.

By improving Model C, Model D addresses the most pressing effectiveness issues discussed in models A, B, and C. Still, the model requires strong Executive leadership to make it feasible. Its new approach to the Threshold system should help address the problems with accountability mentioned in Model C. Model D also addresses country ownership weakness specifically mentioned in Model B and C, since Threshold Gold works fundamentally on a state and regional level where 'true' democratic participation is likely easier to facilitate. If DFA-administered funds used to supplement the MCC do not significantly cut into PEPFAR and other particularly politically attractive programs in the Foreign Operations Budget, concerns over political control will be limited. Also, the 'Development Assistance Assurance Clause' and new regulations for the Compact and Threshold programs address important shortcomings in the models.

Although Model D has established a strong and applicable framework for effective aid, its results unfortunately can only be determined by the future. Although some suggest a sunset date for the MCA/MCC, which can be reworked if the program yields results in line with its mission, this is probably unnecessary in part because it was not already written in the MCC's founding legislation. Further, given Model D has more promise for meeting MCC mission/goals than the current MCC, *it* does not need a sunset provision. Still, if a sunset provision is required it should be at least a decade, or another reasonable amount of time taking into account the inherent lag in results of aid programs.

Conclusion

Neither Model A, B, or C are extremely effective models of aid distribution, thus we have little reason to believe they will be more effective in the future. Channeling more aid through an amended model, Model D, however, will substantially improve the overall effectiveness of aid. Model D is also applicable to the future because it is politically and fiscally feasible, and demands a reasonable restructure of foreign assistance possible with the proper Executive leadership.

Aid can still continue to have a "strategic" and "ideological" focus in Model D. Model D aid is not awarded to countries that necessarily "deserve" it, but rather funds a current core strategic and ideological objective of US aid: effectiveness. The fact that Model D might award aid to "deserving" countries is only a bi-product of the model. As long as effectiveness remains an objective of the US, Model D is a viable model of foreign aid reform.

Our nation's strategic and ideological goals, of course, will be determined by the future. If our goals are encouraging effective aid as a potential means for alleviating poverty, Model D will work well. If our goals are building strategic partnerships—making strong alliances with countries stable and capable enough to meaningfully represent US interests of economic cooperation, combating terrorism, preventing the proliferation of WMDs, and curtailing international drug traffic—Model D will also work well. The degree of political and administrative commitment to the core objective of effectiveness, however, determines exactly how much aid will be distributed through the model and whether it might be used to replace aid systems currently outside DFA and MCC administration.

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APPENDIX – FIGURE A

Institutional Ranking and MCC Country Selection

Compact & Threshold Dummy

Multiple R	0.0980
R squared	0.0096
Adjusted R squared	-0.0387
Std. error	19.5922

	Coefficient	Std. error	t-stat	P-value
intercept	101.7895	4.494	22.6461	8.54E-25
Compact dummy	-2.0971	7.0519	-0.2973	.7676
Threshold dummy	-4.5394	7.2243	-0.6283	.5332

Regression Analysis Key

Y variable: 2006 Institutional Ranking, World Economic Forum GCI

2 X variables: dummy Compact country, dummy Threshold country

Observations: 44

X variables were not stat. sig. individually or measured together (see table to the left).

A second regression was run with and without countries prohibited from receiving direct USG aid, but the P-value(s) did not significantly change in the stat. sig. direction. A second Y variable of Institutional GCI score, instead of ranking, was also tested for both regressions, but the P-value(s) for these regressions did not significantly change in a stat. sig. direction.

Conclusions:

These findings do not mesh with the assumption that MCC countries, since they score well on MCC indicators, have comparatively better institutions than those with worse indicator scores. There are several possible reasons for this seeming contradiction, some of which have to do with the methodology of the regression:

1) Countries in similar income brackets may have institutions that are not all that different.
2) Institutional quality might not matter as much for MCC selection as suspected. This may challenge:
  a) the theory that institutional strength is key for development
  b) the notion that MCC indicators accurately gauge a country’s potential for economic growth and development
  c) the idea that the GCI ranking system is an appropriate measure of development or economic growth potential
3) This study may be flawed because it only uses 44 observations (only LIC countries)--the only countries that are both MCC and GCI ranked (the 2006 MCC excel scorecard ranks 83 countries, 71 which are not subject to US aid restrictions, and all of which are all LICs). Accordingly:
  a) the limit of 44 countries could restrict the findings
  b) the 44 country limit could suggest that MCC-considered countries not ranked by the GCI were either too small or too institutionally weak to be even considered for such a ranking (which in turn would boost the probability that this study’s P-value is too high)
4) The results may be skewed because countries passing MCC indicator restrictions—scoring over the median on half of the indicators per the three categories and passing the corruption indicator—may also score particularly poorly in at least one MCC indicator, or in an area measured by the GCI but unmeasured by the MCC, which would ultimately drag down those countries overall GCI institutional ranking.
5) The results may also be skewed because LMICs were not included in the regression.

APPENDIX – FIGURE B

Potential Political Factors Determining Distribution of Threshold Program Monies

Institutional Score

Multiple R	0.6123
R squared	0.3749
Adjusted R squared	0.3181
Standard error	11.2922

	Coefficient	Standard error	t-stat	P-value
intercept	45.5092	27.1768	1.6745	0.1221
Inst. score	19.4083	7.5553	2.5688	0.0261

Regression Analysis Key

Y variable: $/millions Threshold Program contracts for all 13 countries

13 X variables: year Threshold $ awarded, population, $ GNI/capita, % Muslim, % below poverty line, # visits by Secretary of State (2001-2007), % GDP military spending, % adult AIDS rate, % exports to US, % imports from US, terrorist safe haven, institutional score, $ US ODA 2005, change in US ODA from 2000-2005.

All variables, except those included, proved less than 94% stat. sig. (on their own and when tested with other variables)

Terrorist Safe Haven

Multiple R	0.5438
R squared	0.2957
Adjusted R Square	0.2317
Std. Error	11.986

	Coefficient	Std. Error	t-stat	P-value
intercept	19.925	3.79	5.2565	.00026
Terrorist safe haven	16.9588	7.890	2.149	.05472

Institutional Score & Terrorist Haven

Multiple R	0.6977
R squared	0.4868
Adjusted R squared	0.3842
Std. error	10.7308

	Coefficient	Std. error	t-stat	P-value
intercept	32.3825	27.3121	1.1856	0.2631
Terrorist safe haven	11.2964	7.6487	1.4768	**0.1704**
Inst. score	15.0050	7.7741	1.9301	0.0824

APPENDIX – FIGURE C

Percentage of LMICs in Compact Program

	Currently funded Compact	Eligible for Compact
Out of currently funded Compacts	36%	45%
Out of all eligible Compact countries	15%	19%

Percentage of LMICs in Threshold Program

	Currently funded Threshold plan	Eligible for Threshold plan
Out of currently funded Threshold plans	23%	7%
Out of all eligible Threshold countries	14%	4%

Percentage of LMICs in Threshold or Compact Program(s)

	Either Threshold or Compact country
Out of currently funded Threshold plans or Compacts	29%
Out of all eligible Threshold or Compact countries	15%

APPENDIX – FIGURE D

Countries receiving the most US Military Aid (excludes Iraq and Afghanistan)

Countries	Military Aid	Income GNI/capita	Pass MCC Income Requirement?	Would be MCC Indicator Scores (# passing green scores/# total possible scores) Ruling Justly	Economic Freedom	Investing in people	MCC country already?	Qualify under MCC indicator and income criteria (score above the mean on at least half per/section)
1. Israel	$2280 mil.	$18,620	F	?	?	?	N	N
2. Egypt	$1,306 mill.	$1,250	P	3/6 P	4/4 P	4/6 P	N	Y
3. Colombia	$558 mill.	$2,290	P	2/6 F	2/4 F	3/6 F	N	N
4. Jordan	$461 mill.	$2,500	P	3/6 P	3/4 P	3/6 P	Y Threshold & rec. for Compact eligibility	Y
5. Pakistan	$698 mill.	$690	P	2/6 F	0/4 F	5/6 P	N	N

Indicator scores and GNI taken from MCC 2007 Country Scorebook

P=Pass; F= Fail; N=No; Y=Yes

There are several revealing findings in this analysis. Although Jordan passed the MCC indicator test in 2006 (3/6 on "Ruling Justly," 4/4 on "Investing in People," 3/6 on "Economic Freedom"), it was only recommended for Threshold assistance in 2006. As of 2007, Jordan was recommended as eligible for MCC Compact assistance. Interestingly, Egypt has passed the MCC indicator test since 2005, however, has never been listed as eligible for Threshold or Compact assistance.

Given these findings, one might speculate. Perhaps Jordan's recommendation as a Compact country over other qualifying countries like Egypt was more a political/strategic decision than a merit based award—especially since Jordan's score on "Investing in People" actually fell from green on 4/4 indicators in 2006 to green on 3/4 in 2007. This suspicion is reasonable given Jordan was pulled into the Threshold Program chiefly by Secretary Rice in the first place--likely because of its proximity to Iraq and reliability as an ally in the Middle East. One might also speculate Jordan was invited to the Threshold rather than the Compact Program in 2006 because Threshold plans give the USG more influence into country plans than do Compacts. This is supported given Threshold Programs have traditionally—and seemingly wisely—been used for countries with corruption problems, however, Jordan received a green score for "Control of Corruption" in 2006, scoring in the 97% range. There seems to be a special reason why Jordan was made a Threshold Program country in 2006.

Lastly, given Jordan's inclusion in the eligibility pool, one might speculate that Egypt's exclusion from the pool was an attempt to avert criticism that the MCA/MCC is just another strategic US aid program for the Middle East.