International Public Management Journal

PERFORMANCE-BASED FOREIGN ASSISTANCE THROUGH THE MILLENNIUM CHALLENGE ACCOUNT: SUSTAINED ECONOMIC GROWTH AS THE OBJECTIVE QUALIFYING CRITERION

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ABSTRACT: *The Millennium Challenge Account (MCA) is the Bush administration's initiative to target foreign assistance to countries that have shown progress in the key areas of economic policy, social development, and governance. While this performance-based allocation of aid is a welcome step, the indicators currently proposed to measure progress are derived from generally subjective judgments and carry considerable margins of error. Using a country's past record of economic growth as the key qualifying criterion for the MCA is a more reliable measure of performance. This article proposes how such a system of measurement can be utilized by the MCA.*

Increasingly since the 1990s, it has become a widely held view within the international development management community that financial aid should be allocated disproportionately, focusing on countries that have already succeeded in creating a policy and institutional environment that will ensure the effective use of aid. This push for performance-based allocation has been motivated by four interrelated factors. First, there is growing concern that aid fails to generate economic growth and poverty reduction, especially among the low-income countries in Africa and elsewhere that have received the most aid (see, for example, Easterley 2001; Lancaster 1999; Healy and Killick 2000). Second, there is mounting evidence that aid conditionality typically fails to compel policy reforms unless the recipient government truly owns the reform program. Hence, it is argued, the task of aid donors should be to find and support reformers, not attempt to make them through the use of *ex ante* conditionality (Collier et al. 1997; Svennsson 2003). Third, it is increasingly recognized that aid money is fungible. Government projects and programs that receive funding would have probably been financed anyway, so aid money is instead used for some undefined marginal activity. Because what you see is not what you get, donors have become more concerned with a government's overall program than with specific

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International Public Management Journal, 7(2), pages 249-270

ISSN: 1096-7494

projects. This implies evaluating the broad environment, rather than the details of a specific project design, for the use of aid money. Fourth, influential econometric analysis, actively promoted by the World Bank, has purportedly shown that, although there is no robust statistical relationship between aid and economic growth in general, aid makes a statistically significant contribution to growth if (and only if) it is given to countries that already have a record of maintaining a good policy environment (World Bank 1998; Burnside and Dollar 2000).

Taken together, these considerations have driven donors to be concerned with a country's overall policy and institutional environment and to direct aid toward those countries with an environment conducive to the effective use of aid money. This view has been expressed with growing conviction since the 1990s in each successive concessional lending window of multilateral institutions. The World Bank has taken the lead by linking its country allocations from the International Development Association (IDA), its soft loan window, to its Country Policy and Institutional Assessment (CPIA), a composite of indicators measuring the quality of economic management, public expenditure priorities, and governance. Bilateral aid donors, however, have been reluctant to move in this direction, which largely reflects the continuing influence of foreign policy motivations, commercial considerations, and old colonial ties in the allocations of bilateral aid (Alesina and Dollar 2000). The Millennium Challenge Account (MCA), a new foreign aid initiative first proposed by President Bush in a March 2002 speech at the Inter-American Development Bank, is the first significant attempt to link bilateral aid explicitly to policy performance (Bush 2002).

The MCA is intended to allocate significant financial assistance, initially up to $5 billion per annum with an expectation of growing to $15 billion per annum in the future, to low- and moderate-income countries that have already shown measurable achievements in three key areas: ruling justly, investing in people, and economic freedom (Bush 2002; see also Nowels 2003). It seeks to competitively select a few countries that are most able to arrive at the intended results of economic growth and poverty reduction by judging whether they meet the minimum threshold under these three performance criteria. This results-based approach may set a precedent in foreign assistance by tying a large sum of foreign aid to *ex ante* performance and outcome of development strategies designed by the low- and moderate-income countries themselves. The Bush administration, in an attempt to use a more objective selection process, has proposed basing judgments on eligibility on a set of publicly available and transparent indicators.

Because of its emphasis on performance and results, as well as its unparalleled sum of aid to development objectives, many anticipate the MCA to be a significant improvement in U.S. foreign assistance. Its success in helping countries improve their economies and reduce poverty largely rests on the ability of the selection process itself to measure countries' capacity for development initiatives. Yet the quantitative indicators currently proposed as the measurements of qualification are subjective, have missing data, and carry large margins of error. A closer analysis of these indicators and the major weaknesses in the sources used to derive them raise questions about their ability to predict performance confidently; missing or inaccurate data may wrongly eliminate certain deserving countries while mistakenly identifying others as qualified candidates.

We propose that a country's past record of sustained economic growth can better capture its commitment to sound development policies while remaining objective, simple, and transparent. This article examines the implications of using sustained economic growth as the selection criterion, and concludes that it is a much better summary index that captures accurately the established performance criteria for MCA qualification.

The article is organized as follows: after this introductory section, the second section reviews the currently proposed methodology for determining which countries qualify for MCA funding. The third section examines the various indicators that would be used in measuring performance and discusses the issues arising from this currently proposed approach. The fourth section examines the use of sustained economic growth as the main determinant of a country's qualification. The final section contains our conclusions.

THE CURRENTLY PROPOSED MCA QUALIFICATION PROCESS

Starting in FY2004, the Bush administration has proposed allocating MCA funds to a group of low- and moderate-income countries that have shown good performance in their approach to development. In the first year, low-income countries (per-capita income below $1,435) that are eligible to borrow from the World Bank's IDA can compete for funding. In the following year, FY2005, all other low-income countries will be eligible to compete. Starting in the third year, FY2006, the pool will expand to include moderate-income countries (per-capita incomes between $1,435 and $2,975). To avoid tilting the selection in favor of moderate-income countries (which are likely to perform better against the various indicators by virtue of their higher incomes), the administration has proposed to score the two income groups separately.

The criteria for MCA funding have been designed to ensure that aid is channeled to only those countries that have a good record of performance in three areas considered key to successful development efforts; namely, good governance (ruling justly in the MCA terminology), social progress (or investing in people), and sound economic policies (or economic freedom). In the current proposal, these areas are to be measured by sixteen quantitative indicators of governance, economic, and human development. Table 1 lists the indicators under the achievements they are designed to measure. Countries that score above the group median on half of the indicators in each category are eligible for MCA funding. The exceptions are inflation, in which the use of a median is replaced by a set rate, and control of corruption, in which a country must score above the median regardless of its performance on other indicators. Missing data in any indicator is considered to be a score below the median. The board of directors of the Millennium Challenge Corporation, a new government corporation that will administer the MCA, will submit a recommendation based on the countries' scores to the president, who will make the final decision. In their assessment, the board will consider gaps in data and other weaknesses of the indicators that might inaccurately reflect on a country's real commitment to economic growth and poverty reduction. Those with current statutory restrictions will be prohibited from receiving MCA funds.

TABLE 1
Currently Proposed MCA Indicators

Ruling Justly	*Investing in People*	*Economic Freedom*
Government effectiveness Source: World Bank Institute	Public primary education spending as percent of GDP Source: World Bank and national sources	Country credit rating Source: *Institutional Investor Magazine*
Rule of law Source: World Bank Institute	Primary education completion rate Source: World Bank and national sources	Inflation Source: IMF
Voice and accountability Source: World Bank Institute	Public expenditure on health as percent of GDP Source: World Bank and national sources	Regulatory policy Source: World Bank Institute
Control of corruption Source: World Bank Institute	Immunization rates: DPT and measles Source: WHO and World Bank	Three-year budget deficit Source: IMF, World Bank, and national sources
Political rights Source: Freedom House		Trade policy Source: Heritage Foundation
Civil liberties Source: Freedom House		Days to start a business Source: World Bank

The sixteen indicators selected to determine MCA qualification are compiled by a variety of sources including the World Bank, Freedom House, United Nations, *Institutional Investor Magazine*, International Monetary Fund, The Heritage Foundation, and national statistics (table 1). The administration chose indicators that were publicly available for most countries and were accurate and transparent. However, despite the intention of using objective indicators, many of their choices come from subjective sources and exhibit other weaknesses in data. This raises serious issues of potential measurement errors (discussed later).

Using the proposed methodology of the administration, Steven Radelet of the Center for Global Development derived a list of countries likely to qualify for the MCA (Radelet 2002; Radelet and Herrling 2003). As more recent data become available, and as the methodology is defined further, Radelet's compilation may differ slightly from the actual list of qualifying countries.[1] Even so, Radelet's analysis provides a good starting point for discussion on the proposed approach. The qualifying countries for MCA funding for FY2004-2006, based on Radelet's methodology, appear in table 2. As he has noted, the separation of low-income countries into two groups in the first two years creates an anomaly, as certain countries that qualify in the first year become disqualified in the second when the median score shifts (since the second year has a larger pool that includes more successful low-income countries, such as China). We assume that this anomaly will be corrected, and for the purpose of this paper assume that the eleven low-income countries that qualify in year one and the three additional countries qualifying in year two would all remain qualified for MCA funding. The middle-income countries that appear in FY2006 in table 2 are in addition to the low-income countries that qualify in the earlier years.

TABLE 2
Qualifying Countries as Defined by Current Methodology

FY2004 (low-income and IDA eligible)	*FY2005 (all low-income)*	*FY2006 (low-middle income)*
Albania	Bolivia	Bulgaria
Bangladesh	China	Egypt
Bolivia	Honduras	Namibia
The Gambia	Malawi	Peru
Georgia	Mongolia	South Africa
Honduras	The Philippines	
Malawi	Senegal	
Mongolia	Sri Lanka	
Nepal	Vietnam	
Senegal		
Sri Lanka		
Total: 11	Total: 9 (3 new, 5 dropped)	Total: 5

ISSUES WITH THE CURRENT PROPOSAL

In general, the concept of using performance as a way to determine the allocation of scarce foreign aid funds is sound. In light of the mixed past experiences with the effectiveness of foreign aid in many countries, it seems entirely appropriate to channel foreign aid funds to countries that have the appropriate environment in place for the MCA's intended results of growth and poverty reduction. As Radelet's (2002) analysis indicates, the sixteen proposed indicators are correlated, to a varying degree of confidence, with economic growth and social development. Other studies have reached similar conclusions about the link between sound economic and governance policies with growth (Mandle 2003; Dollar and Kraay 2002; Burnside and Dollar 2000). There is also evidence that sustained economic growth has a strong likelihood of reducing poverty and improving performance on key social indicators (Fielding 2002; Hsieh and Hsing 2002; Ranis and Stewart 2000). Therefore, it can be concluded that countries that perform well against the administration's sixteen proposed indicators have a good chance of experiencing increased economic growth and poverty reduction.

However, a closer look at the proposed indicators raises questions about the reliability of the conclusions that are drawn from this methodology. Some of these issues have already been pointed out by Radelet. As noted earlier, on a very technical level, the use of the median (rather than the use of an absolute level) is questionable because it results in a shift in the qualifying scores from one year to the next, with countries becoming disqualified when the median changes despite their good progress. Further, Radelet points out the disparity that can occur if good performance is defined as a score above the median rather than at and above the median on a given indicator, since a large number of countries cluster around the median score (Radelet 2002; Radelet and Herrling 2003). The absolute cut-off on corruption can also be problematic and give indefensible outcomes (Kaufmann and Kraay 2002). These are the sorts of technical issues expected to be worked out in due

course. But the currently proposed indicators also carry more fundamental issues that raise questions about their validity.

The most significant data problem is the subjective nature of the judgments that underpin most of the indicators, particularly those related to ruling justly. Four of the six indicators under this heading (government effectiveness, rule of law, voice and accountability, and control of corruption) come from a governance database compiled for the World Bank Institute by Dani Kaufmann, Aart Kraay, and Pablo Zoido-Lobaton (2002), who draw on a broad set of sources to construct a set of aggregate indicators designed to measure different dimensions of the quality of governance. According to the authors, these indicators have substantial margins of error and are not intended for cross-country comparison. The poorest countries have particularly large margins of error, because the sources that the authors use to compile the indicators tend not to cover them. The authors note that "many of the small differences in estimates of governance across countries are not likely to be statistically significant, mirroring the reality that it is in fact difficult to distinguish small differences among countries using this type of data on governance" (Kaufmann and Kraay 2002, 9). This is particularly relevant given that the scores of a large number of countries cluster around the median; consequently, countries scoring just a few points below but still within the margin of error may be disqualified. Thus, the authors suggest focusing on the range of possible governance for each country as defined by its 90 percent confidence interval, or the range in which there is a 90 percent probability that its true score lies within.

The indicators of civil liberties and political rights, which are the remaining two indicators constituting ruling justly, are even more susceptible to error. Based on highly subjective judgments of survey teams from Freedom House (2002), they cannot be taken as highly accurate beyond a broad range. Countries are assigned a score of 1-7 (1 is best) based on their number of raw points collected from a checklist. The potential for error is obvious when we again observe that most countries cluster around the median (say, a score of 4). The actual difference between a country with raw points of 14 and a score of 4, and a country with raw points of 13 and a score of 5 (thus, not qualifying) is questionable. The indicators simply do not lend themselves to precision; they can only be seen as providing orders of magnitude of estimates of inherently unmeasurable subjects, such as civil and political freedom. Countries falling at the top or bottom ends of the scale are probably well placed, but there is surely a large middle range where relative differences are difficult to discern, much less measure.

The social indicators under investing in people raise still other problems. Expenditure data on social-sector spending tends to be incomplete and subject to wide interpretations. It often does not capture spending by the private sector that can be significant in many developing countries. It also does not capture spending by lower levels of government, which can be the major source of expenditures in a federal structure (e.g., India). These data are not reported regularly by many countries, and can be dated. Most significantly, focusing on input indicators of public expenditure in social sectors can be misleading, since they ignore efficiency and effectiveness issues. In developing countries, one finds widely varying education and health outcomes despite similar levels of expenditure (Barnum and Kutzim 1993; Jimenez and Tan 1985; Mingat and Tan 1998; Picazo 2002; Shaw and Grittin 1995). This runs counter to the very concept of performance-based allocation of the MCA.

TABLE 3
Countries Disqualified through Radelet's Analysis of Current Indicators

Reason for Disqualification	*Year One*	*Year Two*
Score on median, not above	Ghana	Albania
	Vietnam	The Gambia
	Guyana	Georgia
		Guyana
Do not pass corruption indicator	Benin	Benin
	Lesotho	Ecuador
	Moldova	Lesotho
	Nicaragua	Moldova
		Nicaragua
		Ukraine
Miss qualification by one indicator	Cambodia	Bangladesh
	Cote d'Ivoire	Cambodia
	India	Cote d'Ivoire
	Mali	India
	Mozambique	Mali
		Morocco
		Nepal

An examination of the low-income countries that just missed qualification in Radelet's analysis illustrates these points. Table 3 provides a list of these countries, organized by the reason for their disqualification. It is difficult to explain, for example, why India does not qualify in the first year while Bangladesh does. Is corruption in Moldova much worse than in Georgia so as to disqualify the former and qualify the latter? Lesotho and Benin are disqualified from funding because of a lack of data on the corruption indicator. The Philippines, with well-known concerns on governance among the development community, qualifies in the second year while India, Morocco, and Bangladesh fail to make the list. All this is to illustrate the issues and anomalies that would arise from the application of the indicators currently proposed for the MCA. Glaring examples that do not match common understanding of the countries would tend to detract from the objective of performance-based aid allocation, and diminish credibility.

SUSTAINED ECONOMIC GROWTH AS THE MEASURE OF QUALIFICATION

The three-part criteria for MCA qualification are designed to single out those countries that have the likelihood of achieving economic growth, poverty reduction, and social progress, and are thus worthy of receiving additional aid funding. Yet, limitations in the data underpinning the indicators discussed above may limit the confidence with which such a judgment can be made. Even if the indicators were accurate, they represent estimates at any one time and thus cannot indicate any underlying trends in progress. There is also the

additional concern of rewarding countries on their assessed future prospects rather than on their actual, demonstrated accomplishments.

We now examine the possibility of using a country's past record of sustained economic growth as the surrogate criterion for the various MCA performance criteria in determining qualification. (The idea of linking aid to growth performance has been suggested by others as well [e.g., Collier et al. 1997]). To the extent that it can be shown to capture the criteria of ruling justly, investing in people, and economic freedom, sustained economic growth would have the advantage of being simple, measurable, publicly available and understood, and not subject to debate about accuracy. By adopting a sufficiently long period of time as the measurement basis, it would also have the advantage of being more robust in its predictive ability: countries that have grown consistently over the years probably also have a good track record of policy performance.

There is already a well-established linkage between sustained economic growth and poverty alleviation, albeit there is some debate on whether the benefits are shared equitably among all income groups (Mandle 2003; Collier and Dollar 2002; Dollar and Kraay 2002; Ravallion 2001; Mazumdar 2000). Nevertheless, the positive correlation between the two is indisputable. There is also strong evidence that rapid and sustained growth contributes to a faster improvement in all social indicators (Hsieh and Hsing 2002; Ranis and Stewart 2000). Figure 1 plots average annual growth rate of GDP per capita over thirty years for all non-OECD countries against the trends in the rate of change of their scores on five key indicators of social development (population growth rate, primary education enrollment, life expectancy at birth, infant mortality, and under age 5 mortality) over the same time period. Virtually every developing country has made progress in each of these areas in the last thirty years. But countries with faster growth have made much more rapid progress in all of these areas.

There is also a well-established correlation between sound macroeconomic policies encompassed in the economic freedom indicator—inflation, regulatory policy, trade policy, and three-year budget deficit—and economic growth (Mandle 2003; Dollar and Kraay 2002; Burnside and Dollar 2000). A fifth component of this indicator, country credit rating, tends to be a composite of these. The sixth component—days to start a business—does not have a significant relationship with economic growth, but this is also the least reliable indicator due to missing or subjective data (Radelet 2002). Overall, there is a high correlation between sustained economic growth and sound economic policies.

Therefore, one can assume that countries that have experienced sustained economic growth meet both the economic freedom and investing in people criteria of the MCA. It is important to emphasize here that this assumption would only hold when there has been a sustained economic growth over several years. Short-term or sporadic growth that may occur from exogenous factors, such as favorable commodity prices or a general improvement in world economic conditions, would not necessarily be a reliable indicator of economic and social policies.

The one new area, and one that represents the most significant departure from the past, is the emphasis on governance, or ruling justly in the MCA proposal. Linking aid to good governance is well justified as good public policy. We undertook an analysis to determine if countries that qualify based on sustained economic growth as the criterion would meet the good governance criteria.

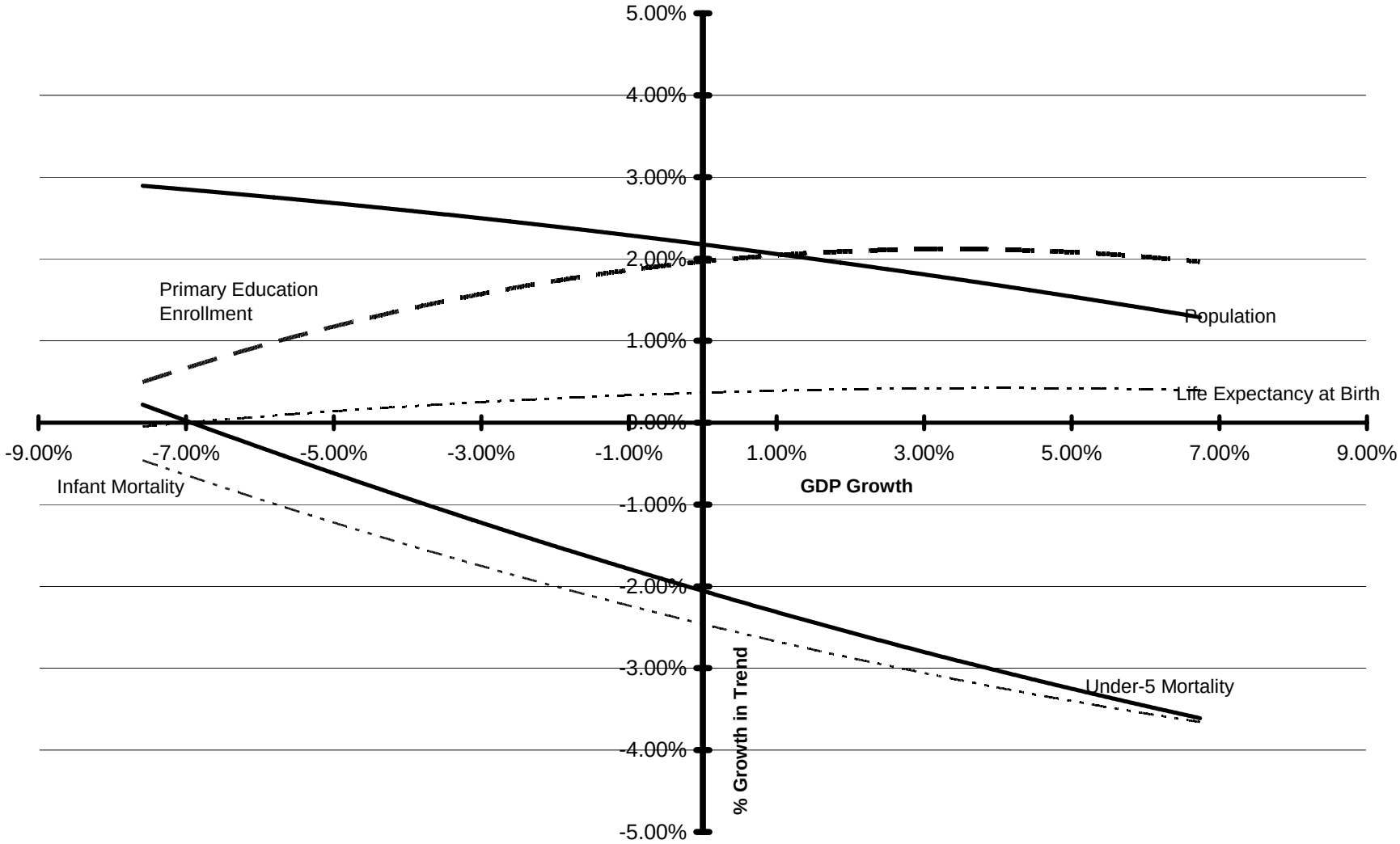

FIGURE 1: GDP Per Capita Growth vs. Trends in Human Indicators (1970-2000)

Source: We used data on GDP per capita (constant 1995 US$), primary education enrollment, population, life expectancy at birth, under-5 mortality, and infant mortality for all non-OECD countries as reported in the World Bank's World Development Indicators (World Bank 2003) for 1970 and 2000, to measure the average growth rate of GDP per capita and the rate of change for the five human indicators over a 30 year period. Not all countries had data for 1970; in those cases, we used the earliest data available after 1970.

We use an average annual per capita income growth rate of at least 2 percent per annum over the ten-year period 1991-2001 as the qualifying criterion for the MCA.[2] The choice of a ten-year period, which is somewhat arbitrary, is used to emphasize only those countries that have a reasonably long track record of performance. While a shorter period could be used, five years is probably the minimum that should be considered. The choice of a 2 percent growth rate is also somewhat arbitrary, but this is probably the minimum necessary to make discernible and tangible progress in poverty alleviation in low-income countries. A growth rate of 2 percent would merely double the per-capita income in thirty-five years. Nevertheless, a somewhat higher or lower number could be defensible. The point is not so much about the choice of numbers; rather, it is the transparent application of the indicator, which is imperative to an objective and precise analysis.

Table 4 compares our new list of low-income qualifying countries to the list compiled by Radelet's use of the sixteen currently proposed indicators.[3] The column on the left lists the countries that qualify by having at least 2 percent economic growth, the column on the right the countries that qualify by Radelet's measurements, and the middle column the countries that qualify through both methods. As noted earlier, in the current MCA proposal the list of qualifying countries in the first two years are different because of the shift in the median score. Here, it is assumed that all low-income countries that qualify in the first year would remain qualified in the second year, while some new countries are added (in other words, we include Albania, Bangladesh, The Gambia, Georgia, and Nepal as qualifying under Radelet's measurements instead of becoming disqualified in the second year).

TABLE 4

Countries That Qualify through Sustained GDP Per Capita Growth vs. through Currently Proposed Indicators

Qualify through Growth Only		*Qualify through Growth and Current Indicators*		*Qualify through Current Indicators Only*	
Country Name	*% Growth*	*Country Name*	*% Growth*	*Country Name*	*% Growth*
Bhutan	3.57	Albania	4.35	Bolivia	0.95
Burkina Faso	2.11	Bangladesh	3.19	The Gambia	0.35
Cambodia	2.04	China	8.85	Georgia	-5.95
Cape Verde	3.20	Nepal	2.52	Honduras	0.39
Ethiopia	2.86	Sri Lanka	3.65	Malawi	0.93
Equatorial Guinea	17.23	Vietnam	5.73	Mongolia	-0.16
Guyana	3.99			The Philippines	1.12
India	4.03			Senegal	1.28
Laos	3.83				
Mozambique	5.05				
Sudan	5.25				
Syria	2.37				
Uganda	3.32				
Yemen	2.37				
Total: 14		Total: 6		Total: 8	

At first glance, there seems to be only a small overlap between the list of sustained economic growth countries and the list derived by Radelet. A total of twenty countries qualify through a measure of growth, as compared to fourteen countries that qualify through the currently proposed set of indicators. Moreover, there are only six countries in common between the two criteria. But as we analyze below, most of this difference is accounted for by the margins of error in the individual indicators.

We focus our analysis here on the six ruling justly indicators from the World Bank Institute and Freedom House. The remaining indicators of investing in people and economic freedom are excluded, because it is already established that these are strongly correlated with sustained growth. Figures 2-5 and table 5 plot the scores of each of the sustained economic growth countries for the six indicators that comprise the ruling justly criteria. For the first four indicators—government effectiveness, rule of law, voice and accountability, and control of corruption—we also plot the range of 90 percent confidence as recommended by the authors of the governance database and as provided by the World Bank (Kaufmann, Kraay, and Zoido-Lobotan 2002) instead of the point estimates proposed by the MCA and used by Radelet. For the remaining two indicators—political rights and civil liberties—Freedom House does not provide a range of estimates. Thus, to account for the imprecision among the middle-range scores, a range of 1 is used around the median (of 5 and 4.5, respectively) to determine qualification.[4]

Applying the range of estimates results in a significant change in the number of qualifying countries under each of the six indicators. Using the Bush administration's methodology, in which a country must qualify on at least three of the six indicators and score above the median on corruption, we arrive at a revised list of qualifying, sustained growth, low-income countries.[5] We refer to this as the revised Radelet list and summarize the results in table 5

This amended approach, which determines qualification based on a reasonable and recommended range of estimates for each indicator (rather than a more questionable point estimate), indicates a very significant overlap between the countries that qualify by sustained growth and the revised Radelet list. Seventeen of the twenty sustained growth, low-income countries qualify under the revised methodology. Only three countries—Bhutan, Equatorial Guinea, and Sudan—do not. The first two are disqualified simply because of a lack of data. Bhutan would likely qualify if data were available, but Equatorial Guinea would not because of its well-known reputation for corruption; its growth has been largely fueled by oil. Thus, Equatorial Guinea and Sudan raise the issue of false positive when sustained growth is the qualifying indicator.[6]

As previously mentioned, the MCA methodology includes a vetting process by the MCA's board of directors that will temper the technical evaluation with their overall judgment, which takes into account factors such as weaknesses in data, their own knowledge of country circumstances, and probably the country's political situation. It would not be difficult for the MCA board to disqualify false positives like Equatorial Guinea and Sudan, the former because of corruption and the latter because of statutory restrictions that prohibit it from receiving foreign assistance. While there would still be room for applying their own assessments in the qualification process, the board can make more robust political judgments by relying on sustained growth as an objective starting point, instead of trying to reconcile the large number of anomalies that would likely result from the subjective and at times unreliable nature of the currently proposed indicators.[7]

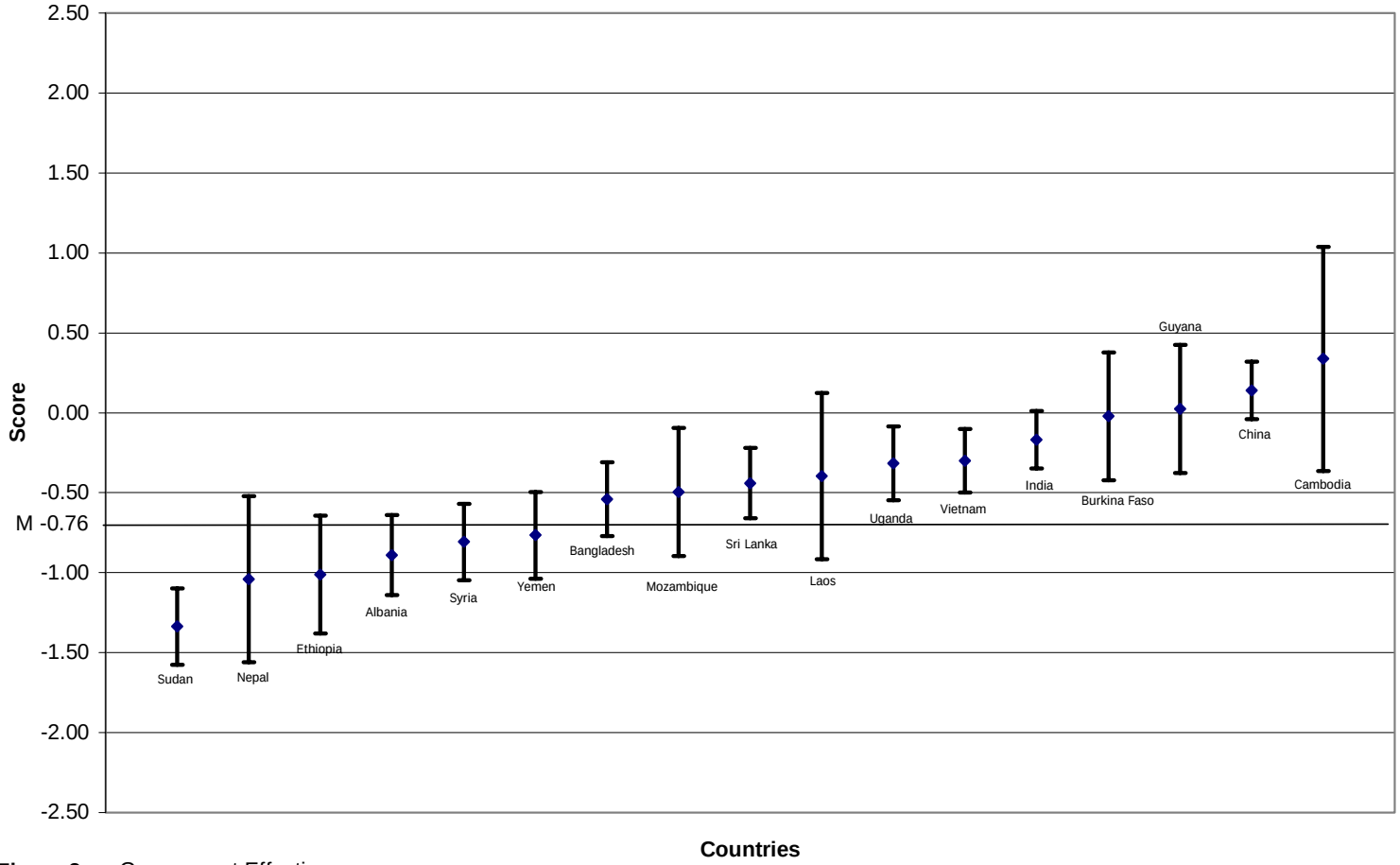

Figure 2: Government Effectiveness

Note: Median = - 0.76 (-2.5 to 2.5, 2.5 = best)
Source: Adapted from Kaufmann, Kraay, and Zoido-Lobaton 2002.

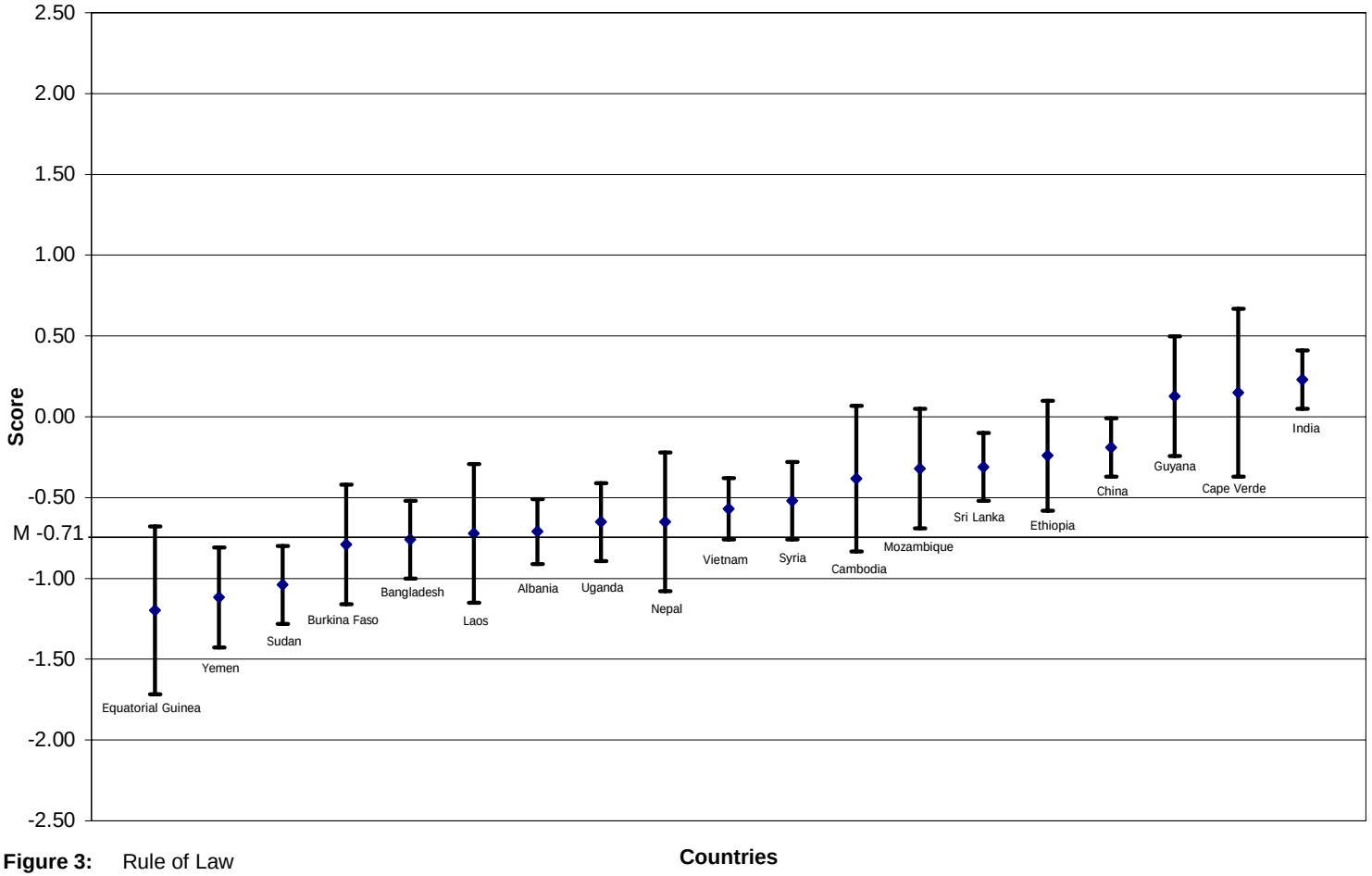

Figure 3: Rule of Law

Note: Median= -0.71 (-2.5 to 2.5, 2.5=best)
Source: Adapted from Kaufmann, Kraay, and Zoido-Lobaton 2002.

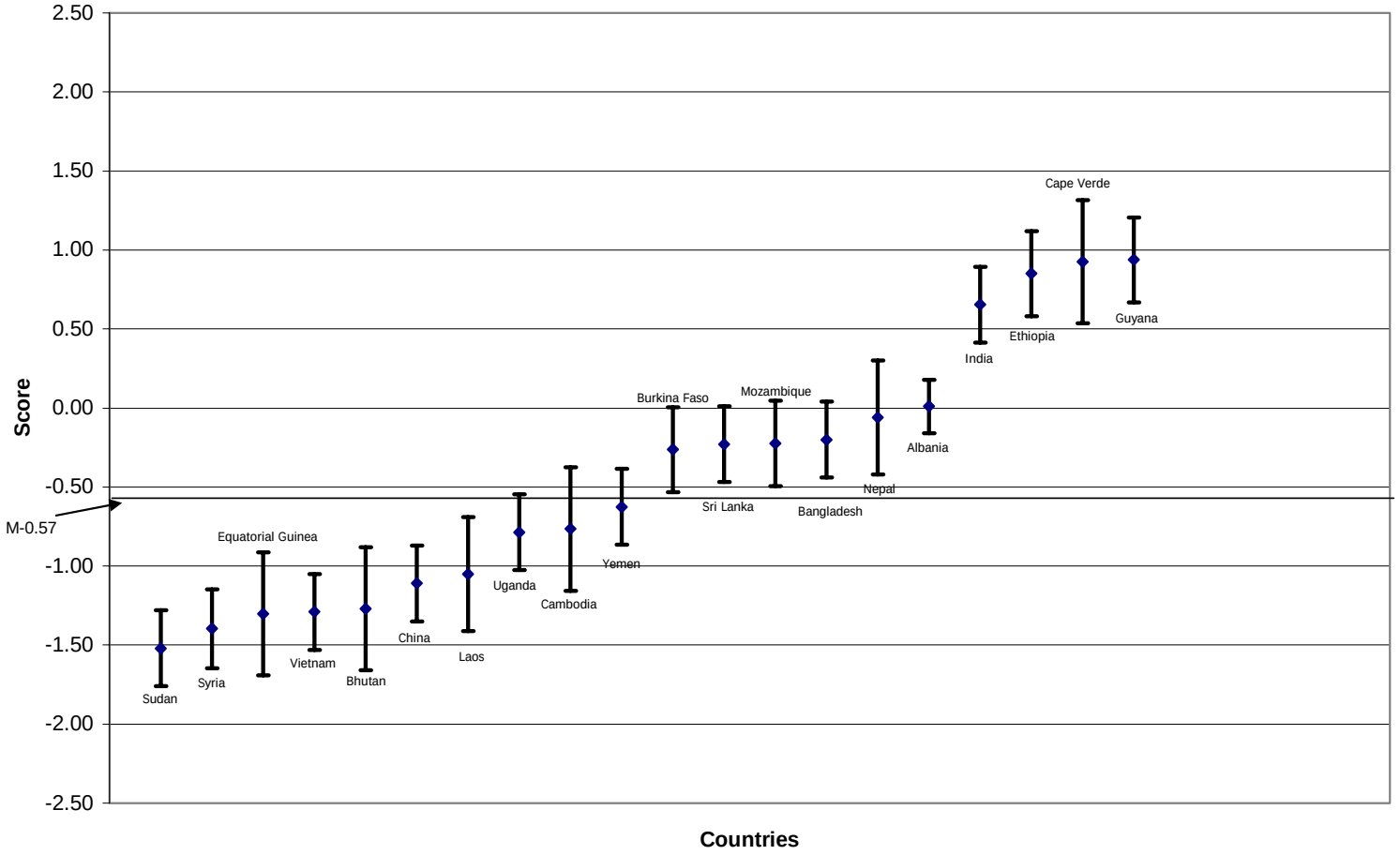

Figure 4: Voice and Accountability

Note: Median= -0.57 (-2.5 to 2.5, 2.5=best)
Source: Adapted from Kaufmann, Kraay, and Zoido-Lobaton 2002.

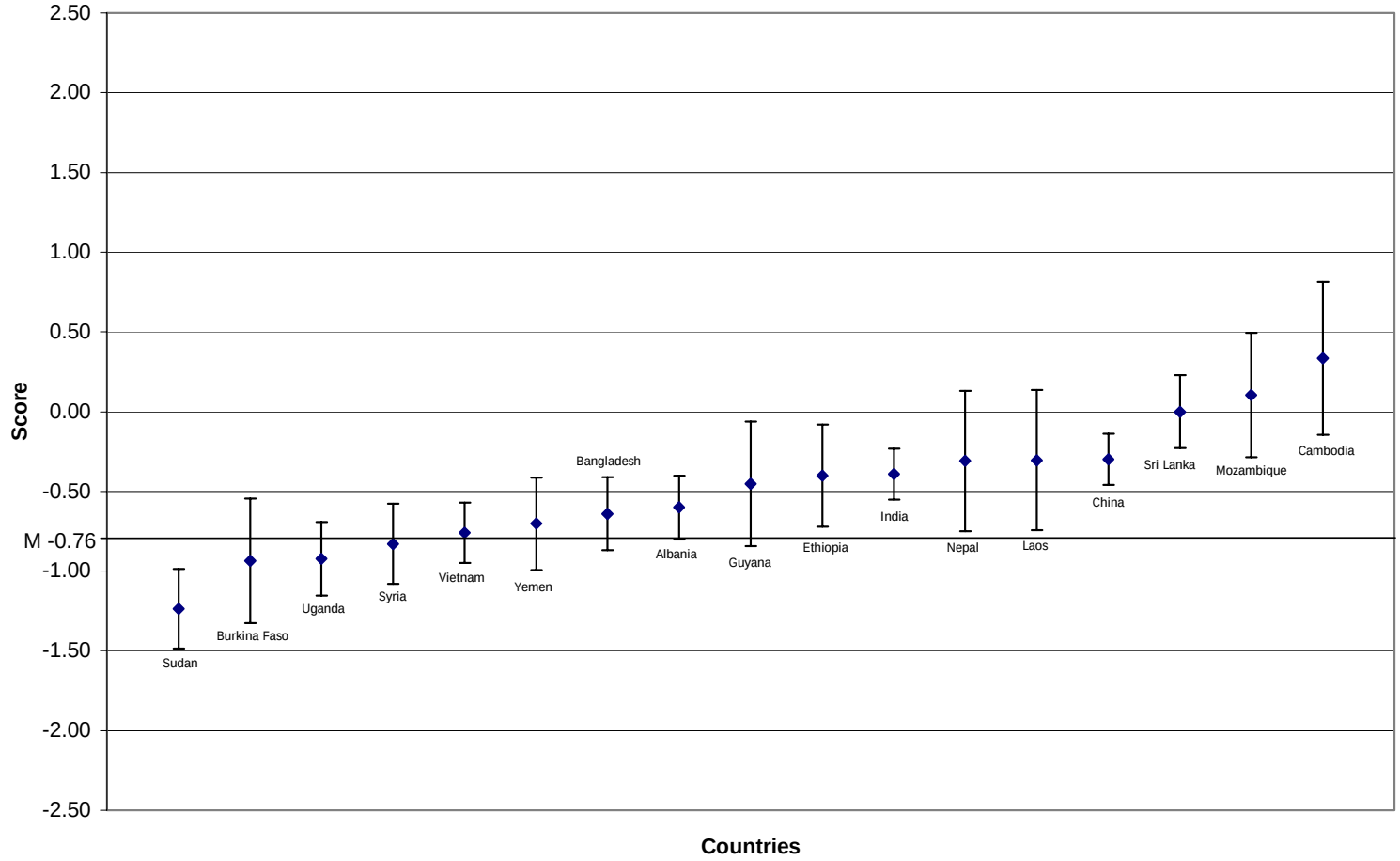

Figure 5: Control of Corruption

Note: Median= -0.76 (-2.5 to 2.5, 2.5=best)
Source: Adapted from Kaufmann, Kraay, and Zoido-Lobaton 2002.

TABLE 5
Political Rights and Civil Liberties

	Political Rights Median = 5.0 (1 to 7, 1=best)		Civil Liberties Median = 4.5 (1 to 7, 1=best)	
Country	*Score*	*Qualify with range of 1*	*Score*	*Qualify with range of 1*
Albania	3	√	4	√
Bangladesh	3	√	4	√
Bhutan	6	√	7	
Burkina Faso	4	√	4	√
Cambodia	5	√	6	
Cape Verde	2	√	1	√
China	7		6	
Ethiopia	5	√	5	√
Equatorial Guinea	6	√	6	
Guyana	2	√	2	√
India	3	√	2	√
Laos	6	√	7	
Mozambique	4	√	3	√
Nepal	3	√	4	√
Sri Lanka	3	√	4	√
Sudan	7		7	
Syria	7		7	
Uganda	5	√	6	
Vietnam	7		6	
Yemen	6	√	6	

Source: Freedom House 2002

It is also instructive to look at the eight countries that qualified through Radelet's approach but did not make the list of sustained growth countries (table 4). It is difficult to make a judgment from this list as to which of these countries are deserving of MCA funds despite mediocre or poor historical growth performance. Some would argue that a number of them have been following sound policies but have not been able to maintain sustained economic growth because of external factors beyond their control (Guillamont and Chauvet 2001). Bolivia and the Gambia are two countries from this list where such an argument can be made. However, this argument does not mean that increased funding would actually help countries reach the MCA's intended results of economic growth and poverty reduction. Taking an understanding approach to such countries can have the danger of basing decisions on future hopes rather than on demonstrated performance. It is just as likely that there are many microeconomic constraints, often not captured by the broad macro indicators, which are inhibiting their development. Aid agencies can probably best assist in these cases by undertaking detailed diagnostic work to identify the real constraints that can be acted upon by the countries, rather than by simply providing additional funds.

TABLE 6

Using Range of Estimates to Arrive at Revised Radelet List

Sustained Growth Low-Income Countries	*Per Capita Income 2001 (constant 1995 US$)*	*Avg. Per Capita GDP Growth 1991-2001*	*Qualifying Countries Per Radelet's Analysis*	*Government Effectiveness*	*Rule of Law*	*Voice and Accountability*	*Control of Corruption*	*Political Freedom*	*Civil Liberties*	*Revised Radelet List*
(1)			**(2)**	**(3)**	**(3)**	**(3)**	**(3)**			**(4)**
Albania	1,230	4.35	√	√	√	√	√	√	√	√
Bangladesh	370	3.19	√	√	√	√	√	√	√	√
Bhutan	640	3.57		*	*		*	√		*
Burkina Faso	210	2.11		√	√	√	√	√	√	√
Cambodia	270	2.04		√	√	√	√	√		√
Cape Verde	1,310	3.2		*	√	√	*	√	√	√
China	890	8.85	√	√	√		√			√
Ethiopia	100	2.86		√	√	√	√	*	√	√
Eq. Guinea	700	17.23		*	√		*	√		*
Guyana	840	3.99		√	√	√	√	√	√	√
India	460	4.03		√	√	√	√	√	√	√
Laos	310	3.83		√	√		√	√		√
Mozambique	210	5.05		√	√	√	√	√	√	√
Nepal	250	2.52	√	√	√	√	√	√	√	√
Sri Lanka	830	3.65	√	√	√	√	√	√	√	√
Sudan	330	5.25			√					
Syria	1,000	2.37		√	√		√			√
Uganda	280	3.32		√	√	√	√	√		√
Vietnam	410	5.73	√	√	√		√			√
Yemen	460	2.37		√		√	√	√		√

* = no data available
√ = qualifying for particular index
Notes:
(1) Low-income countries that have an average annual growth rate of 2% or more over the ten year period, 1991-2001
(2) Countries with point scores above the median in three of the six criteria and above the absolute hurdle for corruption
(3) Countries whose range of estimates fall above the median
(4) Countries whose range of estimates fall above the median in three of the six criteria and above the absolute hurdle for corruption

With limited aid, the choice of any indicator will always result in an unavoidable trade-off of countries that qualify. Given the choice, it is better to avoid subjective criteria that qualify countries despite their not having delivered on the fundamental responsibility of improving the welfare of their people. Unfortunately, many aid organizations have a notoriously poor record of predicting future performance; their internal incentive systems generally make them paint a rosier picture of the future prospects for their clients to allow them to make new aid commitments.[8] Qualification based on subjective judgments may also, over time, create the moral hazard of political considerations creeping into MCA decision making.

While it still remains undecided how a country that initially receives MCA funds will be evaluated for future funding, there is a good possibility that those that have maintained significant economic growth will continue to move toward the MCA's intended results of future growth and poverty reduction. They will thus be more able to qualify for future MCA funding that sustains their development initiatives. Absent any confidence in a government's ability to deliver results, countries that have not achieved sustained economic growth may be better assisted through other programs for basic needs and global public goods that can be targeted directly to the poor through grants to nongovernmental organizations (NGOs).

CONCLUSIONS AND DISCUSSION

The MCA is a commendable concept. Its approach to channeling aid to countries that have the appropriate policy and governance environment is critical to reverse the growing skepticism toward foreign aid. It has long been evident that foreign aid can help countries that are helping themselves but will probably be ineffective in pushing countries to reform. The MCA recognizes important lessons from past aid allocations which show that, ultimately, money is not the binding constraint for development; it can only help when it is provided in the right environment.

The performance criteria proposed for measuring MCA qualification are appropriate. All show a positive correlation with growth and poverty reduction. They are also intuitively appealing to those who generously provide scarce public funds for foreign aid. However, the sixteen indicators currently proposed by the administration are questionable in their ability to confidently measure qualification. Most of these are inherently subjective, as they are based on opinion surveys. They thus have a wide margin of error, particularly for the large group of countries in the middle 50-60 percent of the distribution of scores. Using these indicators as a signal for good future performance could give erroneous qualification for the MCA, both by excluding some otherwise well-performing countries and by including others who may not have good prospects for growth and poverty reduction.

We recognize that a motivation for using the proposed indicators could be to signal their importance and to influence policy.[9] The signaling effect can indeed be important since, for example, the mere fact that donors focus explicitly on the criterion of good governance will no doubt give prominence to its importance among policymakers. By suggesting economic growth as the criterion for MCA qualification, we do not intend to minimize the importance of the proposed indicators. Indeed, we would recommend that the indicators continue to be used in the vetting process by the MCA board after an initial qualification based on the past performance of sustained growth. Whether the currently proposed process can influence policy is a much more difficult question to answer. Past experiences with the ability of

aid—and the conditionality that accompanies it—to influence policy has not been encouraging (Collier 1997; Collier et al. 1997; Singh 2002; Svensson 2003). A demonstrated record of performance, in our view, is a much more reliable predictor of effective aid.

Some may also question whether our proposal would disqualify countries that, for reasons of geography or other similar constraints, have not been able to grow in the past and face poor prospects for the future. Many African countries would fall into this group. This issue, of course, would arise in any adopted approach since, as our analysis shows, most of these countries are also unlikely to qualify through the current MCA indicators. Nevertheless, the argument may well have some resonance among the aid community and may require some additional consideration. Our recommendation would still be to maintain sustained economic growth as the qualifying criterion for the MCA (and what we hope would be a trend for other forms of aid as well) with perhaps a somewhat lower, but still positive, threshold for qualification. However, if countries are unable to meet even a more lenient criterion of sustained growth, it would be difficult to argue that they should receive MCA funding when it is clear that such assistance has little prospect of improving incomes and reducing poverty. Such countries perhaps carry more fundamental institutional constraints to their development, which are unlikely to be overcome by the provision of aid. There may be a need for donors to consider limited programs for capacity building and social welfare programs implemented through NGOs until the necessary institutions for ensuring aid effectiveness are established.

Our analysis shows that sustained economic growth is a reliable indicator of performance, and captures well the intensions behind all of the proposed indicators. It is objective, measurable, publicly available, and not subject to varying interpretations. It also reinforces the concept of performance-based aid rather than the traditional approaches to funding that are often predicated on promises of future action. Using a main criterion of sustained economic growth will likely carry more qualified countries to the MCA's intended results of increased economic growth and poverty reduction, which is the Bush administration's chief objective.

NOTES

1. Since the writing of this paper, new data for 2002 has become available. While Radelet had not revised his analysis based on the new data at the time of our writing, our assessment is that it would not substantially alter Radelet's analysis, nor our conclusions. For Radelet's latest analysis based on the new data, see Radelet (2003), *Challenging Foreign Aid: A Policymaker's Guide to the Millennium Challenge Account*, Washington, D.C.: Center for Global Development.

2. We calculate growth rates of GDP per capita (constant 1995 US$) as reported in the World Bank World Development Indicators (2003).

3. While we focus our analysis on low-income counties for simplicity's sake, we assume that the findings here will also apply to the moderate-income countries that will be eligible for funding in FY2006.

4. In practice, maintaining the qualifying criteria for these two indicators (as done by Radelet) does not alter our results. We have simply used the range to illustrate how the indicators could be used to avoid errors arising from spurious accuracy in point scores.

5. We use the median scores compiled by Radelet for FY2004 but note that if we had used the median scores of the second year, the number of countries that qualify by growth that fall above or below the medians would not change.

6. The recently released dataset for 2002 now includes information for Bhutan and Equatorial Guinea, which in Radelet's analysis were disqualified specifically for missing data. If the same median scores were used as our present analysis, Bhutan, as we hypothesized, would qualify with scores of 0.93 for government effectiveness, 0.10 for rule of law, -1.17 for voice and accountability, and 0.91 for control of corruption. Equatorial Guinea would still disqualify, with scores of -1.37 for government effectiveness, -1.19 for rule of law, -1.44 for voice and accountability, and -1.89 for control of corruption.

7**.** National accounts data can, of course, also be subject to error and manipulation. But it is certainly not nearly as subjective as the World Bank and Freedom House governance indicators. It is also subject to much more scrutiny and transparency.

8. Although the over-optimism in economic projections is well known in development institutions, a systematic evaluation has not been done on the medium-term growth performance of countries as compared to the projections made when funding allocations were first decided. Unsatisfactory growth performance in the large number of countries undertaking structural adjustment illustrates this point. Based on internal data from the World Bank, twenty of the thirty-eight African countries that made use of structural adjustment loans from the World Bank between 1980 and 2000 experienced a decline in per-capita incomes. Only five relatively small countries (Botswana, Lesotho, Mauritius, Seychelles and Swaziland) showed a per-capita income growth of more than 2 percent per annum. In Latin America, Chile is the only major country to have experienced a per-capita income growth rate of over 2 percent, with most of the other nineteen recipients of structural adjustment—including Argentina, Brazil, and Mexico—experiencing only modest growth. In Eastern Europe, Latvia is the only country among those receiving structural adjustment loans to have experienced more than 2 percent growth in per-capita income. A recent International Monetary Fund study confirms the bias in forecasts towards optimism (IMF 2003).

9**.** We are grateful to an anonymous reviewer for articulating this important point.

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