

Misconceptions Surrounding the Millennium Challenge Account -- Michael Crosswell, USAID, October 2007¹

Thank you very much for your presentation, particularly the helpful analysis of the issues that MCC is facing and the implications for USAID's important, complementary role in countries with actual or potential MCC programs.

Let me preface my remarks by expressing my high regard for MCC as an institution. It has a clear, important mandate which it is able to pursue with considerable autonomy; a highly-qualified professional staff; and a strong results orientation. It is clearly a "learning" organization that recognizes the issues confronting it and tries to analyze and resolve those issues in a sensible manner.

Let me also endorse the core proposition underlying the MCA – that foreign aid tends to be more effective in countries making strong self-help efforts in terms of policy performance. That principle has guided USAID and U.S. foreign aid legislation since the early 1970s.

All that being said, I believe MCC is laboring under a number of misconceptions. I attribute these misconceptions to the original sponsors of MCA rather than to MCC itself. Nonetheless, these misconceptions have had major, enduring impacts. They are at the root of many of the issues and challenges facing MCC. And, they handicap not only MCC but also USAID. I mention these not to point fingers, but rather to help us jointly consider how we can get ourselves out from under the burden that these misconceptions impose on us.

1. The first misconception is that "*MCA eligible countries clearly have very good policies.*"

The more accurate statement is that "*MCA eligible countries have **relatively** good policies -- as gauged by the "hurdles" methodology and compared with their peers.*" The hurdles methodology requires countries to rank above the *median* for *at least half* of the indicators of policy performance in three areas – ruling justly, promoting economic freedom, and investing in people. That's sixteen indicators in all. However, consider that:

- The comparators are other low-income and lower-middle income countries.
- The median values are both literally and figuratively "mediocre". This becomes clear when we look at each median value, and the country associated with that score.
- An MCA eligible country may not be far above the median for the hurdles that it "passes", and may be below the median for as many as half of the indicators.

¹ Comments in response to Rodney Bent's Presentation, "The Role of the Millennium Challenge Corporation in Economic Development", October 17, 2007. (USAID Economic Growth Officers Workshop, October 15-19, 2007; Washington, D.C.). These are personal views of the author, and do not represent official USAID or F positions.

- Accepting the hurdles approach as a very good method for identifying MCA eligible countries, it remains true that there are other good methods for appraising policy performance (e.g. the World Bank Country Policy and Institutional Assessments) and they can readily lead to different rankings of countries.
- More generally, identifying good policies is an art as much as a science, and there is plenty of room for imprecision and uncertainty. This calls for some humility.

2. The second misconception is that “*since MCA eligible countries have very good policies, they have strong, capable institutions.*”

The more accurate statement is that “*MCA eligible countries have institutions with weaknesses that are typical of low-income and especially least-developed countries.*”

- Good institutions are a function not only of political will, but also resources – financial resources, human capital, technology, physical infrastructure, etc. Consider what it takes for “effective rule of law” or “effective regulation of trade and financial markets” or “effective provision of social services”. In poor countries all of these resources are very scarce – that’s one of the primary rationales for foreign aid. Consequently, institutions in poor, less-developed countries are typically weak rather than strong, almost by definition of the term “less-developed”.
- Further, the indicators of policy performance used by the MCC are (quite properly) designed to isolate *political will and commitment, and not capacity*. Where the indicators are tied to governance and institutional performance, the hurdles approach is careful to compare countries with their peers, thus controlling for resource availability and level of development. (MCC could go further in this direction, by sub-dividing the group below \$1735 per capita income using the IBRD threshold for low-income countries of \$905 (2006 per capita income))

3. The third misconception is that “*since MCA eligible countries have very good policies and capable institutions, what they mainly lack for rapid growth is aid in the form of large resource transfers.*”

The more accurate statement is that “*to achieve or maintain growth, MCA eligible countries (and others) primarily need to continue improving policies and strengthening institutions.*”

- That is arguably the most important determinant of economic growth in any developing country.
- Further – and particularly in Africa – any poor country with relatively good policies already attracts a large volume of donor assistance, to the point where many are concerned with absorptive capacity, Dutch Disease, and disincentives for good/improved governance.

4. The fourth misconception is that “*since MCA eligible countries have strong institutions, these large resource transfers can be delivered in the form of projects and*

programs (e.g. for infrastructure and/or rural development) with relatively little in the way of donor programming effort.” Despite the size of MCC programs there is no need for significant in-country staff and significant involvement in the formulation and review of programs and proposals for compacts. The recipient can and should do most of the work, on the basis of which a compact – including expected results – can be readily negotiated. (This misconception was surely of great attraction to OMB – foreign aid managed on the cheap.)

The more accurate statement – as revealed by MCC experience and the widespread concern and apparent surprise that MCA resources disburse much more slowly than expected – is that *“since MCA recipients have the institutional weaknesses and limitations typical of poor countries, they face major difficulties in coming up with program and project proposals that would satisfy a conscientious but “arms length” donor like MCC.”* Contrary to the hopes and expectations of OMB and others, you can’t simply pick the “right” countries and then hand over the money in a relatively simple transaction.

5. The fifth misconception is that *“MCA eligible countries have achieved a distinct stage of development, akin to Rostow’s take-off stage”*. There was always awareness of the possibility of backsliding in policy performance in discussions of the MCA. However, this was expected to be a very limited phenomenon – partly because of the attraction of MCA resources and the threat that programs would be cancelled in the event of serious backsliding.

This misconception was particularly evident in the subsequent “Foreign Assistance Framework” -- the center-piece of U.S. aid reform -- where countries that passed the requisite number of hurdles were assigned to the “transforming” group as opposed to the “developing group”. The perceived task of U.S. foreign aid was to get remaining countries from the developing to the transforming group, after which MCC would “take over” (at least where economic growth programs were concerned) and rapid growth would follow.

The more accurate statement is that *“good policy performance is not a stage of development. It can be transitory, especially insofar as it depends on political will and self-help efforts. Relatively good policy performance can be even more transitory, because it depends partly on the performance of other countries. Further, good policy performance identified by an approach based on median values for sixteen indicators in a large sample of countries can be even more transitory.”*²

- “Stages” or levels of development are more accurately identified by indicators that tend to systematically improve with development progress – economic indicators such as per capita income, the share of agriculture in the economy,

² To clarify, we can have absolute measures or criteria for policy performance, and then identify the countries that perform well on those measures compared to other countries, e.g. the top twenty or thirty per cent for the IBRD’s CPIA. There is even more relativity when the measures themselves are relative, e.g. the *median* score for days required to start a business.

openness to trade and other measures of integration in the international economy; and social indicators for health, education, fertility, etc.

- Expressed somewhat differently, lower-middle income countries that are MCA eligible (El Salvador) have much more in common with lower-middle income countries that are NOT eligible (Guatemala), than with low-income countries that are eligible (Benin).
- Good policy performance is manifestly NOT a stage of development. Indeed, donors concerned with selectivity consciously seek measures of policy performance such that poor/least-developed countries have a clear chance to score well. This has been true for MCC, the World Bank, and USAID.
- With accumulated experience over several years in applying the hurdles approach, it is clear that the list of countries identified by that approach is far from stable, with a significant number of countries falling off the list over time. This belies the notion of stage of development.

6. A further misconception – or part of the preceding one – is that *MCA eligible countries are in a stage of development characterized by sharply accelerated/ very rapid growth (akin to the “takeoff” to self-sustained growth).*”

The more accurate statement is that *“The growth performance of MCA eligible countries since 2001 does not stand out from the performance of non-MCA eligible countries”*.³

- Around half of MCA eligible countries are growing at rates at or below the median for their region -- Benin, Madagascar, Mali, Gambia, Senegal, Honduras, Bolivia, El Salvador, Mongolia, Vanuatu, and East Timor.
- And, there are plenty of countries not eligible for MCA with growth rates at or above the average rate for MCA eligible countries.

7. A seventh misconception is that that *“countries with MCA compacts will soon graduate from dependence on foreign aid by virtue of their rapid growth.”* The original concept of MCA certainly did not envision prolonged access to MCA resources but rather one or at most two five-year compacts.

The more accurate statement – simply a matter of applying realistically feasible growth rates to current levels of per capita income – is that *“most MCA eligible countries are decades away from reaching the per capita income eligibility threshold for MCA resources, currently around \$3500 per capita.”*

Concluding comments: It is apparent that these misconceptions have shaped assumptions – within OMB, the NSC and other parts of the USG and also in Congress -- about how MCC should operate; the focus of MCC programs; the relationship between MCC programs and USAID programs in economic growth. This has been to the

³ Based on average annual growth in per capita income for 2001-08, including IMF projections for 2007 and 2008, as reported in “The Not-So-Elusive Quest for Growth; Recent Economic Performance and Prospects for Developing Countries”, by Michael Crosswell, USAID. Presented to the (same) Economic Growth Officer’s Conference, October 2007.

detriment of both institutions, and to the more general goal of effective foreign aid. They have also handicapped administration efforts to bring greater coherence and strategic focus to foreign aid through aid reform and the foreign assistance framework. A fundamental reexamination -- of the basic premises for MCC and aid reform and of the processes that led to such misconceptions -- is certainly in order.