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Abstract

The paper intends to serve the policy and scholarly community primarily from the Commonwealth of Independent States (CIS) interested in the Millennium Challenge Account (MCA) program. The paper is based on an extensive survey of the recent literature on this topic. It consists of three parts. First, it highlights the development promises of the MCA program in the context of the traditional United States (US) foreign aid strategy and development assistance in general. Second, it highlights the MCA selection process and indicators. Finally, it examines the ranking of the CIS countries on the MCA selection indicators, touching upon controversial issues with respect to the selection of Georgia (as an eligible country) and Kyrgyzstan (as a threshold country). The inspection of the rankings also reveals that governance and corruption remain the main challenges for most of the CIS countries to compete for MCA eligibility.

* Useful inputs were provided by Professor Andrew Glassberg and Robert Baumann at the University of Missouri-St. Louis.

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Lessons Learned: Foreign Aid and Development

Aid was considered essential investment for the less developed countries to catch up with the well-developed part of the world. However, foreign aid has had mixed effects on economic development of the world's poorest countries, leading development scholars and practitioners to question whether aid can indeed bridge the gap between the haves and have-nots. Some scholars claim that aid is necessary for development; others argue that it is harmful. Clemens, Radelet and Bhavnani (2004a) have examined the literature on the relationship between foreign aid and development under several categories, broadly grouped in this paper as follows: (1) *studies that find no positive effect of aid on development* (Mosley, 1980; Boone, 1994; Easterly, 2001, etc); (2) *studies, indicating conditional relationship in which aid has a positive effect in some circumstances but not in others;*[1] and (3) *studies that find positive relationship between certain type of aid (growth oriented aid) and development under different conditions* (Mavrotas, 2002; Clemens, Radelet, and Bhavnani, 2004b).

No positive effect of aid on development: Widespread poverty in Africa and South Asia, especially in such countries as the Central African Republic, the Democratic Republic of the Congo, Tanzania, Haiti, Papua New Guinea, Somalia and others despite several decades of massive aid assistance are widely cited examples of countries in which aid has obviously not worked.[2] Easterly (2001) explains that aid has a negative effect on development by enlarging government bureaucracies, enriching crony elites, and providing negative incentives for the governments to put their internal resources to the best use.

Easterly (2001), in his sample of 138 countries, has found that foreign aid has worked only in one country - Tunisia. In his view, there is no robust economic model that addresses this question and there is not enough empirical evidence that aid is contributive to growth. In his view, foreign aid creates perverse incentives for a recipient country to marshal its resources for development. Easterly (2001) argues that traditional aid strategy violates the fundamental assumption of economics that people and governments respond to incentives. *Expressis verbis,*

[1] Lensink and White (2001) and Dalgaard, et al., (2004) find a positive relationship between aid and development but with diminishing returns. Isham, Kaufmann and Pritchett (1995), Burnside and Dollar (2000), and Collier and Dollar (2002) find that aid works in countries with sound policies and institutions.
[2] Clemens and Radelet (2003: 6) define, "Aid has been unsuccessful if - after receiving years of large aid flows - a country's residents have the same or a lower standard of living."

"there is no reason to think that aid given just because the recipient is poor changes the incentives to invest in the future."

Clemens and Radelet (2003) also note that aid can generate negative incentives, acting as a substitute for government revenues and minimizing the government efforts to build its own sustainable tax base. Large aid flows can also undermine government institutions. For example, Knack (2000) notes that foreign aid can exacerbate corruption because it provides temptations for some bureaucrats to use these funds for personal gains. In addition, some small countries could have the problem of "absorptive capacity" to deal with large aid flows, making macroeconomic management difficult (see Clemens and Radelet, 2003).

Recipient country characteristics: However, to argue that aid is totally irrelevant is to ignore certain success stories. For example, the success of Marshall Plan in rebuilding Europe is undeniable. It is also believed that by initiating sound policies and reforms, South Korea, Botswana (in the 1960s), Indonesia (in the 1970s), Bolivia and Ghana (in the 1980s), Uganda and Vietnam (in the 1990s) have greatly benefited from foreign assistance (World Bank, 2005). In 1960s, Botswana received large amounts of foreign aid ($70 per capita or 19 percent of GNI), which, in combination with sound management of diamond deposits and democratic institutions, led to average 6-7 per cent growth between 1965 and 2001. The mixed results on the effect of foreign aid on development have stimulated research on the role of foreign aid under different circumstances and conditions. Brainard et al., (2003) note that foreign aid has failed because of many factors beyond the control of donor organizations. Clemens and Radelet (2003) delineate difficulties that countries can face in absorbing large aid flows. The crucial findings from this research are that aid saturation point ranges from 15 to 45 percent of GDP and its effectiveness depends on the quality of institutions and policies that a country enjoys.

The quality of institutions and policies broadly termed as governance has become the turning point in allocation decision of the major donor organizations. The idea is based to a large extent on the research of the World Bank economists, Burnside, Dollar and Collier, who show that aid has a positive relationship with growth in countries with good policies and institutions and little or no effect in others (Burnside and Dollar 2000; Collier and Dollar 2002). Moreover, Collier and Dollar (2002) have found that countries ranked low on the quality of policies and institutions have aid saturation point of 19 percent of GDP while countries with sound policies and institutions can effectively absorb aid of 43 percent of GDP (Clemens and Radelet, 2003: 7).

Development and growth oriented aid matters: A recent study by Easterly, Levine and Roodman (2003) extend Burnside and Dollar data set and find that the initial results are not robust to new data points, different time frames, varying definitions of aid, and alternative definitions of policy. However, Radelet (2003a) notes that the mixed results by different scholars should not be surprising for several reasons: smaller impact of foreign aid on development relative to other factors, empirical growth studies can be inherently weak with data missing for many countries/variables that may strongly influence growth, large portions of foreign aid historically were given to strategic allies who did not always use it for development.

Clemens, Radelet and Bhavnani (2004a) point out that the aggregate level empirical studies, showing zero or negative impact of aid on development, can be biased because of the flawed assumption that *all aid is intended to promote growth.* The scholars argue that most research on aid and growth is flawed, for two reasons: *substance and timing.* On *substance*, most studies look at the relationship between total aid and growth, when large portions of aid are not directed at growth (e.g., food aid, medicines, bed nets, and school books are directed at supporting consumption, not growth). Aid is also given for humanitarian assistance or to promote democracy and is not expected to be correlated with per capita income.

On *timing*, studies do not differentiate the possible short-run versus long run output of aid programs. For instance, the impact of aid aimed at infrastructure (roads, bridges, telecommunication facilities, etc) or at supporting agriculture and industry can reasonably be assessed within a short time horizon. At the same time, aid aimed at education, health or institutional reforms may affect development positively but its impact can be assessed more or less viably only after a long period of time (at least decades). The implication is that studies that assess the impact of the two different types of aid within the same time period can be flawed. The solution is to use the longer time period; however, the dilemma is, "the longer the time period, the harder it is to isolate the impact of aid on growth from other influences" (Clemens, Radelet and Bhavnani, 2004a: 8).

Clemens, Radelet and Bhavnani (2004b) examine the relationship between growth-oriented aid and growth across 67 countries between 1974 and 2001. They divide aid into three categories: (1) *aid for disasters, emergencies, and humanitarian efforts* (they expect negative relationship); (2) *aid oriented at growth indirectly or in the long term,* such as institutional reforms, investment in health and education (they expect zero effect in short term); and (3) *growth-oriented-aid in the short term*: (a) infrastructure, such as roads, irrigation systems, electricity generators and ports, and (b) aid to support productive sectors, such as agriculture, industry, trade and services (they expect positive relationship). The scholars find a positive relationship between the short term "growth oriented aid" and per capita incomes over a four year period. In addition, the results confirm the diminishing returns with larger amounts of aid having smaller impact on growth. They also find that the impact of aid is somewhat larger in countries with sound institutions though institutions are not necessary for aid to exert positive effect on development.

The two implications can be drawn from the recent innovative studies on the role of aid in development. First, aid directed specifically to development can positively be associated with per capita incomes. Second, aid seems to work in countries with sound institutions and policies. At some point, it makes a sense that those countries with sound structure of governance, absence of systemic corruption and sound economic policies aimed at development are expected to use aid accountably and effectively. The Millennium Challenge Account (MCA) program is precisely based on this premise.[3]

The Millennium Challenge Account[4]

In March 2002, in Monterrey, Mexico, President Bush stated, "I am here today to announce a major new commitment by the United States (US) to bring hope and opportunity to the world's poorest people" (White House News, 2002). He announced the creation of a bilateral development fund, the MCA, as the US contribution to the United Nations Conference on Financing for Development. According to the plan, Bush pledged US$1.7 billion for FY 2004, US$3.3 billion for FY 2005 and US$5 billion for FY 2006, representing a 50 percent increase in the amount of aid focused strictly on development assistance (Shaeffer, 2002). This marshaled the largest US foreign aid increase in decades. Steve Radelet (2003a) wrote in Foreign Affairs, "This move was one of the greatest surprises of George W. Bush's presidency so far." Indeed,

[3] Sperling and Hart (2003: 9) note, "The proposed MCA is a step forward because it builds on an emerging consensus that development works best when poor countries have strong policies on governance and economic reforms and take responsibility for reducing poverty and spurring economic growth."
[4] The *Center for Global Development* and *Brookings Institute* in Washington D.C. have produced majority of research on this new initiative. Key books on this topic are: *Challenging Foreign Aid: A Policymaker's Guide to the Millennium Challenge Account* by Radelet (2003b) and *The Other War: Global Poverty and the Millennium Challenge Account* by Brainard et al., (2003).

the MCA could bring about the most fundamental changes to U.S. foreign assistance policy since the Kennedy administration (Natsios, 2002).[5]

The MCA in the Context of the US Foreign Assistance:

Historically, the bulk of U.S. foreign assistance did not have economic development as its primary purpose. Instead, it was based on foreign policy goals. Brainard et al., (2003) note that though development assistance was originally intended to address development needs, decisions on aid allocation were based on foreign policy priorities. In other words, aid was given primarily to strategic partners. During the Cold War, foreign aid was mainly allocated to contain communism. For example, Taiwan, South Korea, Turkey, Vietnam, and others have received aid from the US on this principle. In addition to the containment of communism, the aid was allocated to advance US foreign policy in hydrocarbon abundant Middle East. As a part of the Camp David accords, Washington also provided a large share of ESF[6] to Egypt and Israel, which are considered the largest aid recipients up to this day (Radelet, 2003a; Brainard et al., 2003).

The allocation of aid on strategic consideration has continued to be the dominant modus operandi long after the end of the Cold War.[7] For example, after the demise of the U.S.S.R, the US has been very active in providing assistance to the formerly communist countries to advance democratic and free-market reforms. The political gains have been tangible as well. Eastern Europe and Baltic States have joined the European Union and popular democratic revolutions have occurred in Georgia, Ukraine and Kyrgyzstan. However, outside of formerly communist countries, Middle East and South East Asia, the US has somewhat lost coherent strategic rationale for aid allocation. The overall US assistance to poor countries also fell by 25 percent (Radelet, 2003c).

After September 11, foreign aid gained attention again. The Bush administration pledged US$297 million to Afghanistan, US$600 million to Pakistan and US$250 million to Jordan to

[5] President Kennedy called for greater aid selectivity in 1961 when he established the USAID, envisioning that an independent aid agency could allocate aid based on development needs.

[6] Washington's aid accounting makes a key distinction between developmental assistance and geopolitical aid, which is distributed to strategic countries mostly as economic support funds (ESF) (e.g., the Iraqi Relief and Reconstruction Fund, and the Emergency Response Fund for Afghanistan) (Sachs, 2005). According to Sachs (2005), 16 countries plus the West Bank and Gaza Strip received about half of the total U.S. bilateral assistance in 2003, even though they accounted for only 11 percent of the population of developing countries receiving U.S.

[7] For example, allocation of bilateral economic assistance on the basis of political and security considerations in 2003 was US$4.84 billion or 26 percent of the fiscal 2003 budget. Security assistance, which includes foreign military considerations, was US$5 billion or 27 percent of the fiscal 2003 budget (Brainard et al., 2003).

fight terrorism and promote democracy (Radelet, 2003a: 108). But the main surprise was the initiation of the MCA. To manage the MCA, the Millennium Challenge Corporation (MCC) was established on January 23, 2004 as an independent corporate style agency to avoid political pressures, bureaucratic procedures and multiple congressional mandates that have characterized previous aid programs.[8] Establishing a new corporation, however, is not without risks. It could further fragment foreign assistance programs and policies, which are already spread across numerous overlapping agencies (Brainard et al., 2003).

In view of the increases in foreign assistance to post-war Iraq, Afghanistan and Pakistan to fight terrorism and to Africa to fight AIDS, the Congress could not commit itself to President's original generous pledge to initiate the MCA program. But it has still gone from vision to operation. The Congress managed to appropriate US$1 billion in FY 2004 and US$2.3 in FY 2005 to organize and pilot the MCA program. The President seeks US$3 billion for FY 2006, double the FY 2005 level, but less than the original US$5 billion commitment for the third year (Nowels, 2005). Even if the real funding is lower than the originally pledged in Monterrey, Mexico, it stills represents one of the drastic increases in foreign assistance in a half a century, outpaced only by the Marshall Plan and the Latin America focused Alliance for Progress in the early 1960s (Radelet, 2003b; Brainard, et al., 2003; Nowels, 2005).

The MCA Strategy:

Other than marking a dramatic increase in bilateral aid, the MCA is also a drastically different aid allocation strategy. First, the MCA has a clearly defined objective to promote development. Second, the MCA emphasizes country ownership in development, recognizing that a country's own commitment, initiatives, policies and institutions play a substantial part in its development outcomes. Third, it is intended to allocate aid based on results. Finally, a relatively small number of recipient countries are selected based on their demonstrated commitment to development (Herrling and Radelet, 2003).

[8] The MCC is governed by a cabinet-level board of directors represented by the chairperson (the Secretary of State), vice chairperson (the Secretary of Treasury), the US Trade Representative, the Administrator of the U.S. Agency for International Development (USAID), and managed by a CEO appointed by the President, by and with the advice and consent of the Senate (MCC Overview, 2005).

Clear-cut development objective: According to Radelet (2003a, 2003c), the U.S. foreign assistance suffers from the attempt to serve too many purposes at once, only one of which is development. The MCA focuses on economic growth and poverty reduction, not other foreign policy goals for at least one part of the U.S. foreign assistance program. If this focus is maintained, it will help reduce tensions arising from multiple and overlapping objectives of assistance, increasing the likelihood for the MCC to achieve its development goals.

Recipient ownership: John Danilovich (2005), the MCC CEO, has recently commented, "Recipient countries, not the donor, should have primary ownership of the Compact, and it is the recipient country that will conceive, develop, and implement its own program - with MCC oversight and monitoring." The approach is based on the premise that increased country ownership of and commitment to development programs lead to better results. The MCC is expected to encourage the government and non-government groups (e.g., NGOs, civil society, etc) in eligible countries to take the lead in designing and implementing their development programs (Radelet, 2003b). This approach calls for groups in qualifying countries to write proposals to compete for funding, in which they spell out specific actions aimed at development.

Results based approach: The MCC plans to provide more generous funding for successful programs, reduce funding for weaker programs, and withdraw funding from programs that fail. Danilovich (2005) has stressed this strategy, "MCC seeks to target those countries most dedicated to breaking the cycle of poverty and ensuring our aid dollars have a transformative impact." However, ensuring strong results require high-quality monitoring and evaluation systems that assess recipient country proposals, progress and the efficacy of the MCA's delivery systems (Radelet, 2003b). Independent and effective monitoring and evaluation systems are also critical to learn lessons from ongoing activities to inform the design of new projects. Finally, the MCC uses a set of *objective criteria of selection* to determine MCA eligibility.

The MCA Selection Indicators and Process

The MCA selection strategy is based on the *need* by countries for the funds and their *performance*.[9] The need criterion is measured by income per capita set by the MCC. [10] The performance criterion is measured by 16 selection indicators under the broad categories of "ruling justly", "investing in people" and "economic freedom" (see Table A).

Table A: The MCA Selection Indicators

Ruling Justly	**Economic Freedom**	**Investing in People**
Civil Liberties	Costs of Doing Business	Public Expenditures on Health/GDP
Political Rights	Annual Inflation	Immunization Rates: DPT3 & Measles
Voice and Accountability	Fiscal Policy	Primary Education Spending/GDP
Government Effectiveness	Trade Policy	Girls Primary Education Completion
Rule of Law	Regulatory Quality	
Control of Corruption	Days to Start a Business	

Note: For a detailed description of each indicator see Box 1 in Appendix
Source: The MCA Report on the Criteria and Methodology in FY 2005 and FY2006

To pass the performance criterion, countries must perform above the median in relation to their peer MCA candidate countries on at least half of the indicators on each of the three policy categories of "ruling justly", "investing in people" and "economic freedom" and score above the median on the corruption indicator. The only exception to the median approach is that for the inflation indicator a fixed ceiling of 15 percent and for civil liberties a fixed score of five are used. In addition to these objective criteria for selection, the MCC can exercise discretion in evaluating the indicators into a final list of eligible countries. Upon necessity, the MCC can also consider other quantitative and qualitative information to determine if a country deems eligible.

The MCA appears to be the first program that employs pre-announced quantitative indicators to select recipient countries (Radelet, 2003a). [11] The indicator test builds on the idea that aid is most effective in countries with governments that are implementing sound

[9] It is important to note that countries must not also be in the list of countries under the U.S. legal prohibition.
[10] In order to qualify, first and foremost, countries must be IDA-eligible with GNI per capita of less than the historic ceiling of the IDA (below US$1,415 in FY2004, US$1,435 in FY2005 and US$1,575 in FY2005. In FY06, the MCC has extended this criterion to the "lower middle income" countries which have higher GNI per capita than the minimum of IDA requirement but below US$3,255.
[11] The administration's proposal to use publicly available, development-oriented criteria to choose countries is a bold attempt to de-politicize the selection process (Radelet, 2003b). Of course, the MCA cannot be completely de-politicized, and tensions with other goals (mainly strategic) may arise in choosing the countries. In allocating funds once countries are selected, strategic partners may get a larger share of MCA funds than other countries.

development policies.[12] The MCC has chosen these selection indicators based on previous research showing that these indicators are linked to development and aid effectiveness.

Ruling justly: The literature on political economy of development has explored different aspects of the concept of "ruling justly" under the rubric of the role of institutions in economic performance (North, 1990; Clague, 1997, etc). Employing aggregate indicators of institutions, cross-sectional studies have found strong influence of institutions over investment, growth and development (Keefer and Knack, 1995; Acemoglu, Johnson and Robinson, 2001; Rodrik, Subramanian and Trebbi, 2002). While institutions provide the "rules of the game", governance has been considered the "play of the game" (Williamson, 2000). Governance and institutions are very much interrelated concepts because the quality of public sector governance in a particular country very much depends on fundamental institutions of that country (Campos and Lateef, 2005).

Kaufmann, Kraay and Mastruzzi (2004) have measured different aspects of governance in general terms, which they define as "the traditions and institutions by which authority in a country is exercised". According to the authors, governance is comprised of: "(i) the process by which governments are selected, monitored and replaced, (ii) the capacity of the government to effectively formulate and implement sound policies, and (iii) the respect of citizens and the state for the institutions that govern economic and social interactions among them." The authors have created governance database comprised of three clusters and known as the World Bank Institute (WBI) governance indicators. The cluster of *voice and accountability* and *political stability* measures the process by which governments are selected and replaced. The cluster of *government effectiveness* and *regulatory quality* measures the capacity of the government to formulate and implement sound policies. The cluster of *rule of law* and *control of corruption* captures the respect of citizens and the state for the rules of the game that govern their interactions (Kaufmann and Kraay, 2002). The MCA uses the WBI governance indicators and democracy ratings from the Freedom House to evaluate the performance of countries on "ruling justly".

Economic freedom: Since the late 1970s, economic freedom has been viewed as the driving force of economic growth manifested in free-market reforms in the form of Thatcherism and Reaganomics in Great Britain and the US. It has been argued that economic freedoms are

[12] For main assumptions of the MCA program, see Figure 1 in Appendix.

essential for market competition, performance and efficiency. Essentially, when businesses are unfettered by excessive government intervention in the form of expropriation of property rights, burdensome regulations, high taxes, etc, they have incentives to invest and expand their activities (De Soto, 1990). In contrast, when the government imposes onerous burden, there is little incentive to produce more and invest into the existing means of production. The indicators of economic freedom used in the MCA selection process are measured by sound macroeconomic management (inflation, trade, and fiscal policy) and regulatory quality (costs of doing business, days to start a business and overall quality of regulatory system).

Investing in people: These indicators include public sector investment in education and health. There are numerous studies that emphasize the role of education in development. Easterlin has noted, "the whole world is not developed because the late arrival of mass primary education in less developed countries" (quoted in Hanson, 1989). The most notably, Barro (1991) used proxies of school enrollment in 1960 to measure human capital. Barro (1991), in his analysis of 98 countries from 1960 to 1985, has found strong relationship between human capital and development. He concludes, "Poor countries tend to catch up with rich countries if the poor countries have high human capital per person" (Barro, 1991: 437). It is also important to note that while investment in education and health are one of the means to facilitate economic development, the quality of education and health are development outcomes along with per capita incomes. Based on this literature, the MCA program assumes that foreign aid is effective and development is possible in countries that commit themselves to "ruling justly," "economic freedom" and "investing in people" (Figure 1 in Appendix).

The MCA Selection Process:

The MCC Board of Directors determined 16 eligible countries for MCA funding in FY 2004.[13] On November 8, 2004, the MCC made its selection of FY 2005 eligible countries. The number and composition of FY 2005 eligible countries remained the same as in FY 2004 except that Board chose one new country (Morocco) and Cape Verde was not selected because its per capita income exceeded the minimum requirement (Nowels, 2005: CRS-8). In FY 2004, the Board

[13] FY 2004 MCA eligible countries are: Armenia, Benin, Bolivia, Cape Verde, Georgia, Honduras, Lesotho, Madagascar, Mali, Mongolia, Mozambique, Nicaragua, Senegal, Sri Lanka, and Vanuatu.

selected ten countries on the basis of the predetermined objective criteria and used some discretion for other six countries.[14]

Lucas and Radelet (2004) have written a detailed paper on the Board's use of discretion. They identify two types of countries affected by the discretion: (1) *countries selected that do not pass the indicators test:* and (2) *countries that pass the indicators test but are not selected.* In FY 2004, Bolivia,[15] Mozambique[16] and Georgia[17] did not pass a strict application of the indicators criteria, yet they were selected to be eligible. Bhutan, Vietnam, Mauritania[18] and Guyana[19] passed the indicators test but were not deemed eligible by the Board. In FY 2005, the Board did not select ten countries that met the minimum standards.[20] Nowels (2005: 12) suspects that scoring "substantially below" in the lowest 25th percentile on one of the indicators has also become "a de-facto criteria for exclusion".

The number of MCA candidate countries has increased in FY 2006 because, regardless of wide criticism from academic and development community, the MCC has added the "lower middle income category" (LMIC) countries to compete for the MCA funds (see Figure 2: Appendix).[21] For FY 2006, the MCC has selected 23 eligible countries. 20 countries are from the "low income category" (LIC) [22] and three are from the LMIC. 16 have been MCA eligible in FY 2005. Burkina Faso, East Timor, Gambia and Tanzania become MCA eligible for the first time in FY 2006 from the LIC. The selected LMIC countries are Cape Verde, El Salvador and Namibia (MCC Press Release, November 2005).

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[14] Cape Verde, Lesotho, Sri Lanka, Bolivia, Georgia and Mozambique

[15] The selection of Bolivia seems like a sensible use of the Board's discretion because it met most of the MCA eligibility criteria (13 out of 16) and scored exactly on the median on the indicator (though the requirement is above the median) (Lucas and Radelet, 2004).

[16] Mozambique met all of the governance and "economic freedom" indicators but it did not meet indicators in the "investing in people" category. It also did not meet the control of corruption criterion (Lucas and Radelet, 2004).

[17] The selection of Georgia has been the most controversial and will be discussed along with other CIS countries.

[18] Although Bhutan, Vietnam and Mauritania met the criteria for selection, they scored below the median on the democracy-related indicators (political rights, civil liberties, and voice and accountability which part of the "governing justly" category). The exclusion of these three countries might set a precedent that it would be very difficult "for non-democracies to be eligible for the MCA" (Lucas and Radelet, 2004).

[19] The exclusion of Guyana is more controversial because it successfully passed 13 of the 16 selection criteria and easily passed the "corruption hurdle" (Lucas and Radelet, 2004).

[20] Bhutan, Guyana, Vietnam, Burkina Faso, China, Djibouti, Egypt, Nepal, the Philippines and Swaziland.

[21] The selection of the countries will be done separately for "low income" and "lower middle income" countries because "lower middle income" countries are ranked much higher on average on "ruling justly" indicators than "low income" countries.

[22] Armenia, Benin, Bolivia, Burkina Faso, East Timor, The Gambia, Georgia, Ghana, Honduras, Lesotho, Madagascar, Mali, Mongolia, Morocco, Mozambique, Nicaragua, Senegal, Sri Lanka, Tanzania and Vanuatu.

How Do the CIS Countries Rank on the MCA Selection Indicators?

Ranking of the CIS Countries in FY 2005:

There are six in FY 2004, eight in FY 2005 and ten in FY 2006 MCA candidate countries from the CIS region (see Table 2: Appendix). In FY 2004 and FY 2005, Belarus, Kazakhstan and Russia were not MCA candidates because they had higher income than the minimum requirement. Uzbekistan has been the only CIS country prohibited from receiving U.S. economic assistance under Part I of the Foreign Assistance Act of 1961.

From the pool of CIS countries, the MCC has selected Armenia and Georgia as MCA eligible. While the selection of Armenia was based on its ranking on the objective indicators, the selection of Georgia was subject to controversy. Lucas and Radelet (2005) report that, in FY 2004, Georgia did not pass four out of the six "ruling justly" indicators (one less than the three necessary to qualify), four out of the six "investing in people" indicators, and three out of the six "economic freedom" indicators. Georgia also did not pass the control of corruption hurdle.

Table B: Performance of CIS Countries in FY 2005

	Ruling Justly	**Control of Corruption**	**Investing in People**	**Economic Freedom**	**Passed Indicators**	**Failed Indicators**	**Missing Data**
Armenia	Passed	Passed	Passed	Passed	14	2	0
Azerbaijan	Failed	Failed	Passed	Passed	7	9	0
Georgia	Passed	Failed	Passed	Passed	10	6	0
Kyrgyzstan	Failed	Equal	Passed	Passed	7	9	0
Turkmenistan	Failed	Failed	Passed	No Data	4	8	4
Tajikistan	Failed	Failed	Passed	Failed	4	11	1
Moldova	Passed	Failed	Passed	Passed	13	3	0
Ukraine	Passed	Failed	Passed	Passed	13	3	0

Note: for calculations, see Table 3 in Appendix

The MCC declared that it would select countries based on their performance and need for the MCA funds. In FY 2005, based on the overall differences between passed versus failed indicators, Georgia performed worse than Armenia, Moldova, and Ukraine and its corruption score was lower than in Armenia, Kyrgyzstan, Moldova and Ukraine (see Table B above and Table 3 in Appendix). Obviously, if performance had been the main criterion for selecting Georgia, then Ukraine and Moldova would have been more qualified. If the need[23] had been the

[23] The level of GNI per capita is an indication of the need for funds.

main criterion for selecting Georgia, then Moldova with two times less per capita income than Georgia would have been better qualified. It is obviously not clear why Georgia was selected instead of, for example, Moldova, which had higher need and better performance than Georgia.

One of the main arguments used to defend Georgia's selection is that it has actively pursued anti-corruption programs[24] and declared its full commitment to democracy. However, Radelet (2004: 5) comments, " [the selection of Georgia] ran directly counter to the core idea of the MCA that countries are chosen on the basis of demonstrated commitment to strong development policies, not on promises." He rightly criticizes that this is a weak rationale because many countries have declared their fight against corruption and created anti-corruption bureaus and instituted new laws, which do not necessarily lead to better governance outcomes.

It is believed that the administration granted eligibility to Georgia to support a geo-strategic ally and a Western oriented President Saakashvili. Georgia was the first CIS country to replace the Soviet political elites by pro-US oriented new leadership. Of course, while such a support of Georgia is justifiable from a U.S. foreign policy standpoint, it is not an appropriate use of MCA funds. Lucas and Radelet (2005) suggest that "the appropriate financial vehicle to support Georgia's transition is the State Department's Economic Support Fund, not the MCA."

On September 12, 2005, the MCC signed a five-year $295.3 million compact with Georgia to stimulate economic development in the poor regions, where more than half of the population lives below the poverty line. The program intends to benefit directly a half-million Georgians and quarter of the population of the country will benefit indirectly (MCC Press Release, September 2005). Apparently, granting an opportunity for Georgia to combat corruption and meet the objectives set by the MCA program is an investment into its future. At the same time, the MCC has been widely criticized for selecting Georgia in spite of its failure to meet the indicator test, which undermines the overall credibility of the MCA program.

In terms of the ranking of other CIS countries in FY 2005, Ukraine and Moldova were high performers. Ukraine and Moldova passed all criteria except corruption. No doubt that Moldova would benefit immensely from receiving MCA funds because, despite its strong performance, it still has income per capita closer to the countries in Central Asia and Caucasus. In terms of weak performers, Turkmenistan, Tajikistan and Azerbaijan ranked the lowest on

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[24] The MCC Board stated that it granted eligibility to Georgia because it the new government established two new bureaus, initiated procurement legislation, and unified treasury accounts and thus committed to improve its governance.

most indicators. Turkmenistan was the worst case scenario, scoring "substantially below" on all "ruling justly" indicators. It also had missing data on two of the "investing in people" and "economic freedom" indicators. Tajikistan failed on all "ruling justly" and on five of the "economic freedom" indicators. Azerbaijan failed on all "ruling justly" with equal to the median indicators of rule of law and civil liberties. In Azerbaijan, it also took more days to start a business than for the countries ranked in the lowest 25th percentile (see Table 3: Appendix).

Overall, "ruling justly" and corruption were the most challenging barriers for the CIS countries in FY 2005. Half of the countries could not perform above the median on at least half of the "ruling justly" indicators. While Armenia, Georgia, Moldova and Ukraine managed to pass "ruling justly" category, only did Armenia pass the corruption hurdle.[25] The control of corruption index is an aggregate gauge of bribery, the costs of corruption in doing business and the capture of the state by vested interests. These are the characteristics of corruption pervasive in all of the CIS countries with particular intensity in Central Asia. It is important to note that corruption is not only a symptom of weak governance but is also a hindrance to governance reforms. In an environment of rampant corruption, it is also much harder to jumpstart demand for governance reforms.

Ranking of the CIS Countries in FY 2006:

Median per capita income in the CIS has increased by 45 percent while the minimum income requirement has increased by ten percent from FY 2004 to FY 2006. In FY 2006, two additional CIS countries (Kazakhstan and Belarus) are added under the category of "lower middle income" (LMIC) countries. Thus, except Russia and Uzbekistan, all CIS countries are MCA candidates in FY 2006[26] (MCC Eligibility Report FY 2006). For FY 2006, the MCC has again determined Armenia and Georgia as MCA eligible. In addition, it has added Kyrgyzstan, Moldova and Ukraine to participate in the MCA threshold program for FY 2006.[27] These countries, especially

[25] Kyrgyzstan had equal to the median and Moldova and Ukraine fell slightly short of the median.
[26] Except Russia, which has a GNI per capita of $3,410, which is higher than the minimum requirement of $3,255 and Uzbekistan, which is subject to Section 577 of the FY2005 Appropriations Act, all of the CIS countries can compete for the MCA funds.
[27] The MCC selected 13 countries to participate in the threshold program for FY 2006, including Guyana, Indonesia, Jordan, Kenya, Kyrgyzstan, Malawi, Moldova, Paraguay, Philippines, São Tomé and Principe, Ukraine, Uganda, and Zambia (MCC Press Release, 2005).

Armenia, Moldova and Ukraine, are also the top performers among the CIS countries on most selection indicators (see Table C).

Table C: Performance of CIS Countries in FY 2006

	Ruling Justly	**Control of Corruption**	**Investing in People**	**Economic Freedom**	**Passed Indicators**	**Failed Indicators**	**Missing Data**
LIC							
Armenia	Passed	Passed	Passed	Passed	12	4	0
Azerbaijan	Failed	Failed	Passed	Passed	7	8	0
Georgia	Passed	Failed	Passed	Passed	11	5	0
Kyrgyzstan	Failed	Failed	Passed	Passed	9	7	0
Turkmenistan	Failed	Failed	Passed	No Data	4	8	4
Tajikistan	Failed	Failed	Passed	Passed	5	9	2
Moldova	Passed	Failed	Passed	Passed	14	2	0
Ukraine	Passed	Failed	Passed	Passed	15	1	0
Uzbekistan	Failed	Failed	Passed	Passed	9	7	0
LMIC							
Belarus	Failed	Failed	Passed	Passed	5	11	0
Kazakhstan	Failed	Failed	Passed	Passed	9	7	0

Note: For calculations and comparisons in number terms, see Table 4 and 5 in Appendix

The CIS MCA Eligible Countries (Armenia and Georgia): Armenia scores higher than the median on 12, equal to the median on two and lower than the median on two out of 16 indicators. It does not fall "substantially below" on a single indicator (see Table 4 in Appendix). It has a strong showing on nine indicators with a clear advantage on "ruling justly" category in relation to its peer CIS countries (see Table 6 in Appendix). With regards to the progress from FY 2005 to FY 2006, it has invested more in education, with improvements in girls' primary education completion rate and education spending. Nevertheless, two indicators on which it still fails are in the category of "investing in people." In the area of governance, it has higher scores on government effectiveness and control of corruption. Yet, democracy indicators deteriorated within one year. John Danilovich has expressed his concern about lack of transparency and commitment to fair elections in the recent referendum in Armenia (MCC Press Release, December 2005). The MCC has promised to monitor closely Armenia's political process with a penalty of withdrawal in case its performance deteriorates further.

Georgia performs strongly on five indicators with particularly strong showing on democracy indicators (Table 6 in Appendix). Because of the drastic efforts of the new government to undertake bold steps to fight corruption and improve governance, it has made the grade on the "ruling justly" category and advanced on most "economic freedom" indicators. It has also managed to improve on the most challenging corruption hurdle from FY 2006 to 2005. Yet, it still comes short of the median and performs worse than Moldova and Ukraine. It is also vulnerable in the category of "investing in people." For instance, though health indicators have improved, primary education completion rate for girls has worsened and primary education expenditure is below the 20th percentile. Obviously, despite the progress, Georgia must do more to justify its being eligible for reasons other than its ranking on the selection indicators.

The CIS MCA Threshold Countries (Moldova, Ukraine and Kyrgyzstan): The selection of Moldova and Ukraine as MCA threshold countries is very much welcoming considering their sound performance on most indicators. *Moldova* performs strongly in nine and passes all "ruling justly" indicators except corruption. It scores above the median on three of four "investing in people" indicators, with minor improvements in girls' education completion rate and the government spending on education in one year. On "economic freedom" category, it passes all indicators. Moldova is the closest country to become MCA eligible from the pool of CIS countries in future rounds.

Ukraine is a strong performer on eleven indicators (Table 6 in Appendix). It scores well uniformly across three categories, demonstrating slight improvements on "ruling justly" indicators. For instance, while, in FY 2005, it had equal to the median scores on government effectiveness and rule of law, it performs above the median on these indicators in FY 2006. In terms of weak performance, it falls short on control of corruption, primary education spending and its inflation rate is close to the median. It is very likely that Ukraine will improve on corruption indicator and thus will pass the indicator test. However, Ukraine, unlike for example Moldova, has access to other sources of funding mainly in the private sector, which should be taken into account by the MCC.

In *Kyrgyzstan*, like in most CIS countries, the main challenge remains "ruling justly". It simply fails all "ruling justly" indicators but without "substantially below" scores. Government effectiveness and civil liberties are equal to the median and control of corruption is marginally less than the median. In view of its very weak performance on "ruling justly" indicators, the choice of Kyrgyzstan as a threshold country has been subject to criticism. For instance, Radelet (November 2005) has written:

> Kyrgyzstan just has no business being a threshold country. It passes zero of the governance indicators - none - and scores particularly poorly on all the democracy related indicators. It is a very good example of the kind of country the MCC was designed to not provide financial assistance to. There are many other countries that are much more suitable for the threshold country than Kyrgyzstan. This choice cries out for explanation.

As Kyrgyzstan does not have sound scores on the "ruling justly" category to be competitive in the next rounds and experts have rightly brought up the issue, the MCC has not provided a detailed explanation for selecting Kyrgyzstan as a threshold country. There might be several reasons why Kyrgyzstan has been chosen as a threshold country.

First, in spite of weak democracy scores in relation to other MCA candidate countries, Kyrgyzstan is often called the "Island of Democracy" with more or less vibrant civil society and freedom of press in comparison to its neighboring authoritarian regimes in Central Asia. Following Georgia and Ukraine, Kyrgyzstan has recently gone through its own "Tulip Revolution", which signifies a change in the long-standing political leadership. The MCC might have decided that Kyrgyzstan has the post-revolutionary momentum to initiate drastic governance and democratization reforms, as it has been the case in Georgia. As Daniel Fried, Assistant Secretary for European and Eurasian Affairs, has stated, "There has been this year a major democratic advance in Kyrgyzstan where the newly-elected leadership, elected in the fairest, freest elections that region has seen, is struggling with reforms" (State Department, 2005). Thus, the MCC might have expressed its generosity to support the newly elected Kyrgyz leadership in the same fashion it has supported Georgia. However, will this generosity transform into real institutional and policy outcomes is a matter of time and political will of the newly formed Kyrgyz government. At this point, the new government is struggling to restore stability and order and it is hard to predict, which way it chooses to move forward.

Second, the MCC might have supported Kyrgyzstan because it has been a very strong political ally of the US and hosts the only US military base in Central Asia in between China and Russia and with proximity to Afghanistan. If this were factored in the decision-making of the MCC, then the so-called independence of the MCC from the US government is very doubtful and this undermines the credibility of the program. Finally, despite the failure of Kyrgyzstan on "ruling justly" indicators, it performs relatively well on "investing in people" and "economic freedom" categories. In the category of "investing in people," Kyrgyzstan passes all indicators. It also ranks relatively well on "economic freedom" indicators, with improved scores from FY

2005 to FY 2006. The only indicator of "economic freedom", on which Kyrgyzstan performs unsatisfactorily, is the budget balance, which is below the 20th percentile. Given Kyrgyzstan manages to improve its governance and fights corruption; it has the potential to compete for the MCA eligibility. It is also essential to pinpoint that Kyrgyzstan has been selected as a threshold not an eligible country and if Kyrgyzstan does not do well on "ruling justly" indicators, the MCC is likely to withdraw from supporting it. However, the MCC should have been more explicit and detailed in justifying its selection of Kyrgyzstan as a threshold country and should have stated its conditions upon which it would decide to withdraw from supporting it.

Other CIS Countries: The governance is the main challenge among the CIS countries, especially in Turkmenistan, Belarus, Tajikistan and Azerbaijan. Turkmenistan and Belarus are clearly the worst case scenarios, scoring "substantially below" on all "ruling justly" indicators. The dictatorial political system in *Turkmenistan* is graded with the lowest possible Freedom House rating of seven in political and civil liberties. It has not progressed on a single "ruling justly" indicator and its rule of law and corruption scores have worsened from -0.4 to - 0.6 within one year. In terms of economic freedoms, it passes on inflation rate and budget balance but fails on regulatory and trade policy. Data on the cost and days to start a business are not available but Turkmenistan is more likely to fail than pass on these indicators because its overall index of regulatory quality is "substantially below".

In *Belarus*, the level of democracy is very disturbing, with the score of seven on political rights, six on civil liberties and -1.61 on voice and accountability. This largely reflects a dictatorial style of governance by Alexander Lukashenko, whom Western NGOs accuse of suppressing human rights and the media. In spite of the state-led economy, Belarus barely makes on "investing in people" category, falling "substantially below" on public spending on primary education and health but passes on immunization and girls' primary education completion rate indicators. In the category of "economic freedom," it fails on costs of starting a business and scores below the 20th percentile on regulatory quality and days to start a business.

Tajikistan scores below the 20th percentile on the World Bank Institute governance indicators and below the median on the Freedom House ratings. From FY 2005 to FY 2006, democracy indicators have not got better and government effectiveness and rule of law have even worsened. In the area of "investing in people", girls' primary education completion and immunization rates have improved but government expenditure on education and health have decreased as a share of GDP (with "substantially below" scores). In the area of "economic freedom," it gets above the passing scores on inflation, fiscal policy, and trade policy. The costs and days to start a business data are missing but Tajikistan is likely to fail on these indicators, considering it falls "substantially below" on the aggregate index of regulatory quality.

In *Azerbaijan*, "investing in people" indicators have picked up within one year. It could be due to its increasing oil exports and revenues which could have increased the government resources to spend more on education and health. Minor progress is evident on other indicators as well. For instance, although Azerbaijan is still characterized by burdensome regulatory system, its quality of business regulations has reached the median and it takes slightly less days to start a business in FY 2006 than it took in FY 2005. The core problem in Azerbaijan is rampant corruption, ranking one of the most corrupt both in the WBI control of corruption index and the Transparency International's corruption perception index. Nevertheless, Azerbaijan has recently committed to improve governance and transparency in its oil and gas sector, which constitutes around 90 percent of all its exports, through the Extractive Industries Transparency Initiate (EITI). The basic idea behind the EITI is that transparency over payments and revenues generated by the development of natural resources (oil, gas and mining) must be used in an efficient, transparent and equitable manner. From the CIS region, Azerbaijan and Kyrgyzstan are implementing the EITI initiative and Kazakhstan has announced an implementation plan.

Uzbekistan is prohibited to participate in the MCA selection process. Nevertheless, even if it were allowed to compete for the MCA funds, it would still be far from being a likely candidate. It ranks below the 20th percentile on all "ruling justly" indicators. In particular, its level of democracy is very disturbing. At the same time, Uzbekistan has a strong showing on "investing in people" category and passes five of six of the "economic freedom" indicators.

The newly added "lower middle income" country of *Kazakhstan* does not qualify for the MCA funds either. Even if it were competing among "low income" countries, it still would not qualify for the MCA funds. While Kazakhstan easily passes "investing in people" and "economic freedom" categories, its quality of governance is poor. It falls "substantially below" in relation to its peer LMICs on all "ruling justly" indicators, with particularly low scores on democracy. However, notwithstanding its poor governance and widespread corruption, Kazakhstan has managed to grow dynamically in recent years due to huge exports of oil and political stability. Indeed, by all economic records, Kazakhstan has been the most dynamically developing country in the CIS.

At the same time, high growth does not mean that Kazakhstan should not improve its governance. Kazakhstan will benefit from improving its governance systems such as, public financial systems, state administration, anti-corruption and transparency initiatives and rule of law. With sound governance and favorable business investment climate, Kazakhstan will encourage more foreign and local private investment. With sound governance, the people of Kazakhstan will benefit from the extraction and development of its rich oil resources and the government will be able to realize sustainable economic development with an eye to the future. Nonetheless, it needs to be taken into account that Kazakhstan can rely on its own internal resources to improve governance and does not urgently need the MCA funds, which is also the case for most middle income countries added as MCA candidate countries in FY 2006. Obviously, it would be much more beneficial if the MCC has just focused on the low income countries.

Conclusion: Governance is the Main Challenge in the CIS

By and large, the selection of Georgia as an MCA eligible and Kyrgyzstan as a threshold country is more based on reasons other than their performance on the indicator test. However, Georgia's performance has improved substantially and given this continuity, Georgia might be able to pass the indicator test in next rounds. Kyrgyzstan is obviously far from qualifying as MCA eligible in next rounds and its selection as a threshold country is controversial. Nonetheless, given a generous consideration of Kyrgyzstan as a threshold country, the new Kyrgyz government is given a chance and resources to rule justly and fight corruption to be competitive for the MCA eligibility in future rounds. The selection of Moldova and Ukraine as threshold countries is very much welcoming considering their strong performance. These countries are also likely to qualify as MCA eligible in next rounds. It would especially be helpful to Moldova, which has low income per capita and does not have access to other sources of money (as, for example, Ukraine).

Most other CIS countries are not likely to qualify for the MCA funds in next rounds given their very poor ranking on governance indicators. Overall, poor governance and pervasive corruption are the main challenges across the CIS region. For instance, while, in FY 2005, the CIS as a region performs above the median on all "investing in people" and on five of the "economic freedom" indicators, it fails on seven of the indicators from the WBI Global Governance Indicators Database (see Table 9: Appendix). In FY 2006, once again, the governance indicators are the most challenging barriers. Out of eleven CIS countries, seven fail "ruling justly" and regulatory quality indicators. Ten countries fail the corruption test and most CIS countries rank low on the voice and accountability and rule of law indicators, meaning that citizens in the CIS not only lack civil liberties, independent media, and equal opportunity to participate in the selection of government officials but they also lack confidence in the laws, judiciary and enforceable contracts.

Nevertheless, it is important to note a slight progress within one year. The CIS countries on average stand slightly better on the control of corruption and voice and accountability in FY 2006 than in FY 2005. But, even high performing CIS countries, such as Armenia, Moldova and Ukraine are far behind developed countries on most indicators of governance and still need to work hard to fight corruption. For instance, corruption scores for Armenia is 0.31 and 0 for Moldova and Ukraine, while it is around two for the US and Canada. On average, the CIS countries are assigned a corruption score of - 0.078 when an average score for the OECD countries is + 1.76 and + 0.07 for the neighboring Eastern Europe and Baltic States. The rule of law has an estimate of - 0.013 for the CIS countries, which is very weak in comparison to the score of + 1.51 for the OECD countries. The two measures indicate that the respect of citizens and the state for the institutions that govern economic and social interactions among them is very weak in the CIS countries.

The same is true with other indicators of "ruling justly", with especially wide difference of voice and accountability estimate between the CIS and OECD countries. Thus, there is much room to improve the process by which the governments is selected and the capacity by which the state provides public goods and services. Overall, all of the CIS countries need to focus on governance and institutional reforms not only to be competitive in the MCA program in future rounds but also to assure a better quality of life for their citizens. Unfortunately, unlike "investing in people" and some of the "economic freedom" related reforms, there is no quick fix for "ruling justly". It takes longer time, political commitment and will to initiate governance and institutional reforms.

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Appendix: Tables and Figures

Table 1: MCA Potential Candidate Countries-FY06

Country	**Income in 2004**	**Aid per capita for 2000-03**	**Country**	**Income in 2004**	**Aid per capita for 2000-03**
Low Income Potential MCA Candidates			Philippines	1170	8
Angola	1030	29	Rwanda	220	41
Armenia*	1120	78	Sao Tome and Principe	370	224
Azerbaijan*	950	31	Senegal	670	44
Bangladesh	440	8	Sierra Leone	200	57
Benin	530	39	Solomon Islands	550	123
Bhutan	760	78	Somalia^		17
Bolivia	960	82	Sri Lanka	1010	21
Burkina Faso	360	35	Sudan^	530	11
Burundi ^	90	22	Syrian Arab Republic^	1190	8
Cambodia^	320	35	Tajikistan*	280	24
Cameroon	800	38	Tanzania	330	37
CAR	310	17	Timor-Leste	550	245
Chad	260	24	Togo	380	11
China	1290	1	Turkmenistan*	1340	9
Comoros	530	44	Uganda	270	33
Congo, DR	120	33	Ukraine*	1260	10
Congo, Rep	770	16	Uzbekistan* ^	460	7
Cote d'Ivoire^	770	28	Vanuatu	1340	169
Djibouti	1030	104	Vietnam	550	19
Egypt	1310	18	Yemen	570	21
Eritrea	180	58	Zambia	450	58
Ethiopia	110	17	Zimbabwe^		14
Gambia, The	290	41	**Lower Middle Income Potential MCA**		
Georgia*	1040	54	Country	Income in 2004	Aid per capita for 2000-03
Ghana	380	35	Albania	2080	99
Guinea	460	30	Algeria	2280	8
Guinea-Bissau	160	60	Belarus*	2120	4
Guyana	990	117	Bosnia-Herzegovina^	2040	163
Haiti	390	22	Brazil	3090	2
Honduras	1030	73	Bulgaria	2740	44
India	620	1	Cape Verde	1770	224
Indonesia	1140	7	Colombia	2000	10
Iraq			Dominican Republic	2080	11
Kenya	460	15	Ecuador	2180	14
Kiribati	970	186	El Salvador	2350	33
Korea North ^		7	Fiji	2690	43
Kyrgyzstan*	400	40	Guatemala	2130	21
Lao PDR	390	50	Iran ^	2300	2

Lesotho	740	35	Jamaica	2900	9
Liberia	110	20	Jordan	2140	133
Madagascar	300	25	Kazakhstan*	2260	13
Malawi	170	41	Macedonia,	2350	124
Mali	360	38	Maldives	2510	79
Mauritania	420	97	Marshall Islands	2370	1174
Moldova	710	30	Micronesia	1990	960
Mongolia	590	91	Namibia	2370	69
Morocco	1520	17	Peru	2360	17
Mozambique	250	67	Romania	2920	24
Myanmar^		2	Samoa	1860	201
Nepal	260	17	Serbia & Montenegro^	2620	157
Nicaragua	790	135	Suriname	2250	47
Niger	230	27	Swaziland	1660	21
Nigeria	390	2	Thailand	2540	1
Pakistan	600	10	Tonga	1830	220
Papua New Guinea	580	43	Tunisia	2630	30
Paraguay	1170	12	Tuvalu		

Note: Criterion for low income countries is GNI per capita below $1,575 and for lower middle income countries is GNI per capita above $1,575 and below $3,255.
There are 69 low income potential candidates and 29 lower middle income potential candidates.
*CIS countries (there are 8 low income and 2 lower middle income CIS countries)
^ Countries excluded for statutory provisions (there are 10 low income and 3 lower middle income countries that are prohibited from receiving the U.S. aid assistance)
Source: GNI per capita in 2004 and aid per capita average for 2000-03 are from the *World Bank Development Indicators*, 2005. Country identification is from the MCC Report FY06.

Box 1: Definition of MCA Selection Indicators

Ruling Justly:

1) *Civil Liberties:* A panel of independent experts rates countries on: freedom of expression, association and organizational rights, rule of law and human rights, and personal autonomy and economic rights.

2) *Political Rights:* A panel of independent experts rates countries on: the prevalence of free and fair elections of officials with real power; the ability of citizens to form political parties that may compete fairly in elections; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies and economic oligarchies; and the political rights of minority groups. (Scale: 1 represents the most free and 7 the least free category in the index of political and rights and civil liberties) *(Source: Freedom House, for methodology of measuring civil liberties and political rights, see http://www.freedomhouse.org/template.cfm?page=35&year=2005*).

3) *Voice and Accountability:* An index of surveys that rates countries on: ability of institutions to protect civil liberties, the extent to which citizens of a country are able to participate in the selection of governments, and the independence of the media.

4) *Government Effectiveness:* An index of surveys that rates countries on: the quality of public service provision, civil services' competency and independence from political pressures, and the government's

ability to plan and implement sound policies.

5) *Rule of Law:* An index of surveys that rates countries on: the extent to which the public has confidence in and abides by rules of society; incidence of violent and non-violent crime; effectiveness and predictability of the judiciary; and the enforceability of contracts.

6) *Control of Corruption*: An index of surveys that rates countries on: the frequency of "additional payments to get things done," the effects of corruption on the business environment, "grand corruption" in the political arena and the tendency of elites to engage in "state capture."
(Scale: 2.5 is the highest and -2.5 is the lowest value in the quality of governance indicator)
(Source: World Bank Institute, for methodology of measuring governance indicators, see http://www.worldbank.org/wbi/governance/govdata/)

Investing in People:

1) Public Expenditure on Health: Total expenditures by government at all levels on health divided by GDP. (Source: National Governments).

2) Immunization: The average of DPT3 and measles immunization rates for the most recent year available. (Source: The World Health Organization WHO).

3) Total Public Expenditure on Primary Education: Total expenditures by government at all levels of primary education divided by GDP. (Source: National Governments).

4) Girls' Primary Completion Rate: The number of female students completing primary education divided by the population in the relevant age cohort. (Source: World Bank and UNESCO)

Encouraging Economic Freedom:

1) Cost of Starting a Business: The Private Sector Advisory Service of the World Bank Group works with local lawyers and other professionals to examine specific regulations that impact business investment. One of their studies measures the cost of starting a new business as a percentage of per capita income. (Scale: Higher cost means worse investment regulatory system, Source: World Bank Group).

1.b) Country Credit Rating was used in FY04 and FY05 instead of *Cost of Starting a Business*: A semi-annual survey of bankers' and fund managers' perceptions of a country's risk of default.
Source: Institutional Investor Magazine (Scale: Higher means better investment environment).

2) Inflation: The most recent 12 month change in consumer prices as reported in the IMF's International Financial Statistics or in another public forum by the relevant national monetary
Source: Multiple.

3) Fiscal Policy: The overall budget deficit divided by GDP, averaged over a three-year period. The data for this measure is being provided directly by the recipient government and will be cross checked with other sources and made publicly available to try to ensure consistency across countries. (Larger the negative number the higher the budget deficit, Source: National Governments and IMF WEO).

4) Days to Start a Business: The Private Sector Advisory Service of the World Bank Group works with local lawyers and other professionals to examine specific regulations that impact business investment. One of their studies measures how many days it takes to open a new business. (Source: World Bank

Group).

5) *Trade Policy:* A measure of a country's openness to international trade based on average tariff rates and non-tariff barriers to trade. (Scale: 5 is best and 1 is worst trade policy, Source: The Heritage Foundation's Index of Economic Freedom).

6) *Regulatory Quality Rating*: An index of surveys that rates countries on: the burden of regulations on business, price controls, the government's role in the economy, foreign investment regulation and many other areas. (Source: World Bank Institute).

Source: MCC Report FY06: MCC Public Document on Identification of Candidate Countries http://www.mcc.gov/countries/selection/index.shtml

Figure 1: Basic Assumptions of the MCA Program:

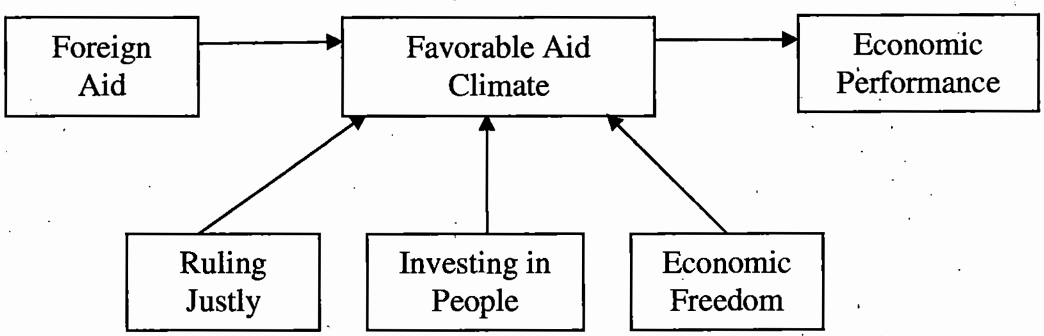
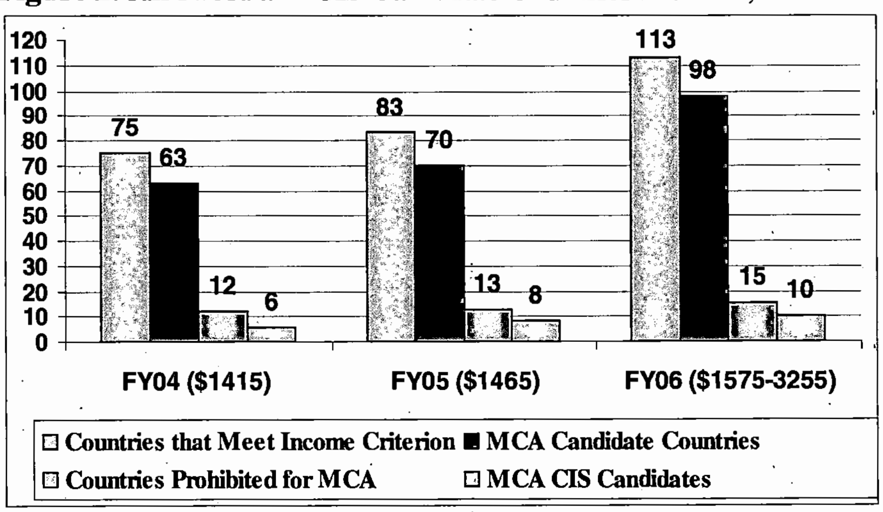


Figure 2: All MCA and CIS Candidate Countries in FY04, FY05 and FY06



Note: For CIS Countries see Table 2 below

Table 2: CIS Candidate Countries and GNI per capita in FY04, FY05 and FY06

FY04 CIS Candidates	**GNI in 2002**	**FY05 CIS Candidates**	**GNI in 2003**	**FY06 CIS Candidates**	**GNI in 2004**
Armenia*	800	Armenia*	950	Armenia	1,120
Azerbaijan	720	Azerbaijan	820	Azerbaijan	950
Georgia*	710	Georgia*	840	Belarus**	2,120
Kyrgyzstan	290	Kyrgyzstan	290	Georgia	1,040
Moldova	470	Moldova	470	Kazakhstan**	2,260
Tajikistan	180	Tajikistan	180	Kyrgyzstan	400
		Turkmenistan	850	Moldova	710
		Ukraine	780	Tajikistan	280
				Turkmenistan	1,340
				Ukraine	1,260
Mean GNI	528		648		1148
Median GNI	590		800		1080
IDA ceiling	**1415**		**1465**		**1575**

*Selected MCA Eligible Countries
** Lower middle income countries with GNI per capita of above $1,575 and below $3,255.
Source: *World Bank Development Indicators*, 2005.

Table 3: Ranking of the CIS Candidate Countries on the MCA Selection Indicators in FY 2005

	MCA		Armenia		Azerbaijan		Georgia		Kyrgyzstan		Turkmenistan		Tajikistan		Moldova		Ukraine	
Indicators	**Median**	**Sub. below**																
Ruling Justly				P		F		P		F		F		F		P		P
Political Rights	<5	6	4	P	6	F	4	P	6	F	7	F	6	F	3	P	4	P
Civil Liberties	4 (<5)*	6	4	P	5	E	4	P	5	E	7	F	5	E	4	P	4	P
Voice and Accountability	> 0	- .53	.3	P	-.3	F	.4	P	-.3	F	-1.2	F	-.3	F	.4	P	.1	P
Government Effectiveness	> 0	- .3	.4	P	-.2	F	0	P	0	E	-.7	F	-.5	F	.1	P	0	E
Rule of Law	> 0	- .4	.3	P	0	E	-.4	F	-.1	F	-.4	F	-.5	F	.3	P	0	E
Control of Corruption	> 0	- .2	.1	**P**	-.3	F	-.2	F	0	E	-.4	**F**	-.2	**F**	-.1	**F**	-.1	**F**
Investing in People				P		P		P		P		P		P		P		P
Girls Primary Completion	> 60.7	39.5	93.1	P	99	P	90.9	P	92.4	P	n/a	?	97.2	P	80.3	P	97.3	P
Primary Education Expenditure	> 1.8	1.1	1	F	2.5	P	.6	F	3.8	P	n/a	?	3.1	P	.9	F	2.8	P
Health Expenditure	> 1.7	.9	1.5	F	1	F	1.1	F	2.1	P	4.1	P	1.4	F	2.7	P	2.9	P
Immunization rate	> 75.25	63.3	94	P	97.5	P	74.5	P	98.5	P	97.5	P	85.5	P	97	P	98	P
Economic Freedom				P		P		P		P		?		F		P		P
Country Credit Rating	> 21.3	16.9	24.1	P	34.5	P	21.4	P	18.7	F	22.3	P	14.1	F	20.6	F	37	P
Inflation	5.4 (< 15)	2.4	6.9	P	2.2	P	4.8	P	8.4	P	n/a	?	16.4	F	13.3	P	5.2	P
Fiscal Policy	> -3.5	-5.8	-1.7	P	-.7	P	-2.1	P	-5.3	F	.2	P	-2.2	F	-.2	P	-.6	P
Trade Policy	< 4	3	2	P	3	P	4	E	4	E	5	F	3	P	2	P	3	P
Regulatory Quality	> 0	-.5	.8	P	-.1	F	-.1	F	.2	P	-1.3	F	-.6	F	.5	P	.1	P
Days to start a business	< 45.5	73	25	P	123	F	25	P	21	P	n/a	?	n/a	?	30	P	34	P

Note: P = passed, above the passing score, F= failed, below the passing score, E = failed but equal to the median score, Substantially below = 25th percentile, in brackets are passing scores when used instead of medians.
Source: Data are from the MCA Country Ranking Dataset FY 2005.

Table 4: Potential Ranking of Each CIS LIC Candidate Countries on the MCA Selection Indicators in FY 2006

	MCA		Armenia		Azerbaijan		Georgia		Kyrgyzstan		Turkmenistan		Tajikistan		Moldova		Ukraine		Uzbekistan	
Indicators	Median	Sub. Below																		
Ruling Justly				P		F		P		F		F		F		P		P		F
Political Rights	< 5	7	5.0	E	6.0	F	3.0	P	6.0	F	7.0	F	6.0	F	3.00	P	4.00	P	7.00	F
Civil Liberties	4 (<5)*	6	4.0	P	5.0	E	4.0	P	5.0	E	7.0	F	5.0	E	4.00	P	3.00	P	6.00	F
Voice & Accountability	> 0	-0.53	0.03	E	-0.29	F	0.35	P	-0.37	F	-1.21	F	-0.43	F	0.22	P	0.07	P	-1.06	F
Government Effectiveness	> 0	-0.39	0.47	P	0.00	F	0.01	E	-0.02	E	-0.56	F	-0.24	F	0.09	P	0.14	P	-0.23	F
Rule of Law	> 0	-0.30	0.28	P	0.00	E	-0.01	F	-0.18	F	-0.57	F	-0.32	F	0.20	P	0.03	P	-0.44	F
Control of Corruption	> 0	-0.19	0.31	P	-0.19	F	-0.07	F	-0.08	F	-0.50	F	-0.27	F	-0.02	F	-0.05	F	-0.36	F
Investing in People				P		P		P		P		P		P		P		P		P
Girls' Primary Education Completion Rate	> 64.4	43.8	108	P	104.5	P	82.0	P	91.4	P	NA	NA	97.5	P	83.2	P	NA	P	101.9	P
Public Primary Education Spending, % GDP	> 2.14	1.22	2.1	F	2.5	P	0.6	F	4.0	P	NA	NA	0.8	F	1.2	F	1.92	P	2.5	P
Public Health Expenditure, % GDP	> 1.89	0.93	1.5	F	1.2	F	5.5	P	2.0	P	3.0	P	0.4	F	2.7	P	3.29	P	2.2	P
Immunization rate: DTP and Measles, %	> 80.5	66.0	91.5	P	97	P	82.0	P	99.0	P	97.0	P	97.5	P	97.0	P	99.00	P	99	P
Economic Freedom				P		P		P		P		?		P		P		P		P
Costs of Starting a Business	< 88.2	160	6.1	P	12.5	P	13.7	P	10.4	P	NA	?	NA	?	17.1	P	10.60	P	15.5	P
Inflation	7.2 (<15)*	20.0	- 2	P	13.5	P	10.3	P	5.1	P	5.9	P	7.1	P	11.2	P	14.78	P	8.8	P
Fiscal Policy	> -3.04	> - 4.8	-1.1	P	- 0.2	P	-1.2	P	-4.8	F	0.2	P	- 2.3	P	-0.3	P	-1.55	P	-0.64	P
Trade Policy	< 4	5.0	2.0	P	3.5	P	3.5	P	3.5	P	5.0	F	3.5	P	2.5	P	2.50	P	2.5	P
Regulatory Quality	> 0	-0.56	0.7	P	0.0	E	0.0	F	0.5	P	-1.6	F	- 0.6	F	0.1	P	0.12	P	-1.5	F
Days to start a Business	< 45.5	73.3	25.0	P	115	F	21.0	P	21.0	P	NA	?	NA	?	30.0	P	34.00	P	35	P

Note: P=passed, F=failed, E=equal to the passing score, "substantially below"=20th percentile from Radelet, Brown and Siddiqi (2005)
*For civil liberties, the MCC uses 5 rather than a 4 and for inflation 15% as passing scores.
Source: Data are from the MCA Country Ranking Dataset FY 2005

Table 5: Ranking of the CIS LMIC Countries in FY 2006

Indicators	**Median**	**Sub. Below**	**Belarus**		**Kazakhstan**	
Ruling Justly				**F**		**F**
Political Rights	> 3	5	7.00	F	6.00	F
Civil Liberties	> 3	5	6.00	F	5.00	F
Voice & Accountability	> 0	-0.60	-1.61	F	-1.29	F
Government Effectiveness	> 0	-0.30	-0.65	F	- 0.34	F
Rule of Law	> 0	-0.39	-0.98	F	-0.65	F
Control of Corruption	> -0.04	-0.30	-0.51	**F**	-0.71	**F**
Investing in People				**P**		**P**
Girls' Primary Education Completion Rate	> 98	91.5	98.21	P	109.88	P
Public Primary Education Spending, % of GDP	> 2	1.46	0.03	F	2.38	P
Public Health Expenditure, % of GDP	> 3	2.13	0.66	F	2.78	P
Immunization rate: DTP and Measles, %	> 90	76.0	99.00	P	90.50	P
Economic Freedom				**P**		**P**
Costs of Starting a Business	< 21	31	22.90	F	8.60	P
Inflation	4.8 (< 15)	20	9.88	P	8.20	P
Fiscal Policy	> -2.02	> - 3.51	-1.29	P	2.50	P
Trade Policy	3.5 (< 4)	4.5	3.50	P	3.50	P
Regulatory Quality	> 0	-0.43	-1.69	F	-0.79	F
Days to start a business	< 39.5	57.5	79.00	F	24.00	P

Note: P = passed, F= failed, E = equal to the passing score.
Source: Data are from the MCA Country Ranking Dataset FY 2005.

Table 6: Strong vs. Weak Performing CIS Countries on Each Indicator in FY2006

Indicators	**Strong performers**	**Weak performers**
Ruling Justly		
Political Rights	Georgia (3), Moldova (4), Ukraine (4)	Belarus (7), Turkmenistan (7), Uzbekistan (7)
Civil Liberties	Ukraine (3), Armenia (4), Georgia (4), Moldova (4)	Turkmenistan (7), Belarus (6), Uzbekistan (6)
Voice & Accountability	Georgia (0.35), Moldova (0.22) Ukraine (0.07), Armenia (0.03)	Belarus (-1.61), Kazakhstan (-1.29), Turkmenistan (-1.21), Uzbekistan (-1.06)
Government Effectiveness	Armenia (0.47), Ukraine (0.14), Moldova (0.08)	Belarus (-0.65), Turkmenistan (-0.56), Kazakhstan (-0.34), Uzbekistan (-0.23), Tajikistan (-0.24)
Rule of Law	Armenia (0.28), Moldova (0.20), Ukraine (0.03)	Kazakhstan (-0.65), Turkmenistan (-0.57) Belarus (-0.39), Uzbekistan (-0.44) Tajikistan (-0.32), Kyrgyzstan (-0.18)
Control of Corruption	Armenia (0.31), Moldova (-0.02), Ukraine (-0.05)	Kazakhstan (-0.71), Belarus (-0.51), Turkmenistan (-0.50), Uzbekistan (-0.36)
Investing in People		
Girls' Primary Education Completion Rate	Kazakhstan (109.9), Armenia (108.1), Azerbaijan, (104.5), Uzbekistan (102)	Georgia (82), Moldova (83.2)
Public Primary Education Spending, % of GDP	Kyrgyzstan (4.0), Azerbaijan (2.48), Uzbekistan (2.48), Kazakhstan (2.38)	Belarus (0.03) Georgia (0.64), Tajikistan (0.79), Moldova (1.16)
Public Health Expenditure, % of GDP	Georgia (5.48), Ukraine (3.30), Turkmenistan (3.04), Kazakhstan (2.78), Moldova (2.71)	Tajikistan (0.40), Belarus (0.66), Azerbaijan (1.21)
Immunization rate: DTP and Measles, %	Belarus (99), Kyrgyzstan, Ukraine (99), Uzbekistan (99)	Georgia (82), Kazakhstan (90.5), Armenia (91.5)
Economic Freedom		
Costs of Starting a Business	Armenia (6.1), Kazakhstan (8.2), Kyrgyzstan (10.4), Ukraine (10.6)	Belarus (22.9), Moldova (17.1), Uzbekistan (15.5)
Inflation	Turkmenistan (5.9), Tajikistan (7.1), Kazakhstan (8.2)	Ukraine (14.8), Azerbaijan (13.5), Moldova (11.2)
Fiscal Policy	Kazakhstan (2.50), Turkmenistan (0.25), Azerbaijan (-0.24)	Kyrgyzstan (-4.83), Tajikistan (-2.31)
Trade Policy	Armenia (2), Moldova (2.5), Ukraine (2.5), Uzbekistan (2.5)	Turkmenistan (5)
Regulatory Quality	Armenia (0.65), Kyrgyzstan (0.54), Ukraine (0.12), Moldova (0.11)	Belarus (-1.69), Turkmenistan (-1.62), Uzbekistan (-1.50)
Days to start a business	Georgia (21), Kyrgyzstan (21), Kazakhstan (24), Armenia (25)	Azerbaijan (115), Belarus (79)

Table 7: Performance of the CIS as a region on the MCA Selection Indicators in FY 2005

All MCA Candidate Countries			**CIS MCA Candidate Countries***			
Variable	*Median (Passing Score)*	*N*	*Median*	*N*	*Indicator*	*Category*
Ruling Justly						**Failed**
Political Rights	< 5	82	6	9	Above	
Civil Liberties	4 (< 5)*	82	5	9	Equal	
Voice and Vote	> 0	82	-.3	9	Below	
Government Effectiveness	> 0	82	0	9	Equal	
Rule of Law	> 0	82	-.1	9	Below	
Control of Corruption	> 0	82	-.2	9	Below	**Failed**
Investing in People						**Passed**
Girls Primary Completion	> 60.7	73	95.2	8	Above	
Primary Education Expenditure	> 1.8	75	2.5	8	Above	
Health Expenditures	> 1.7	79	2.1	9	Above	
Immunization rate	> 75.25	82	97.5	9	Above	
Economic freedom						**Passed**
Country Credit Rating	> 21.3	82	22.3	9	Above	
Inflation	5.4 (<15)*	75	7.65	8	Above	
Fiscal Policy	> -3.5	77	-.7	9	Above	
Trade Policy	> 4	69	3	9	Above	
Regulatory Quality	> 0	82	-.1	9	Below	
Days to start a business	< 45.5	60	30	7	Above	

*For civil liberties the MCC uses 5 rather than a 4 and for inflation 15% is used.
The lower points mean better for political freedom, civil liberties, trade policy, fiscal policy and days to start a business indicators.
Source: Data are from the MCA Country Ranking Dataset FY 2005.

Table 8: Performance of the CIS as a region on the MCA Selection Indicators in FY 2006

Variable	*Median (Passing Score)*	*Substantially Below*	*N*			*Indicator*	*Category*
Ruling Justly							**Failed**
Political Rights	< 5	7	82	6	9	Below	
Civil Liberties	4 (<5)*	6	82	5	9	Equal	
Voice and Accountability	> 0	-0.53	82	- 0.29	9	Below	
Government Effectiveness	> 0	-0.39	82	-0,002	9	Below	
Rule of Law	> 0	-0.30	82	-0.013	9	Below	
Control of Corruption	> 0	-0.19	82	-0.078	9	Below	**Failed**
Investing in People							**Passed**
Girls Primary Completion	> 64.4	43.8	73	97.5	7	Above	
Primary Education Expenditure	>2.14	1.22	75	2.03	8	Above	
Health Expenditures	> 1.89	0.93	79	2.24	9	Above	
Immunization rate	> 80.5	66.0	82	97	9	Above	
Economic freedom							**Passed**
Costs of Starting a Business	< 88.2	160	82	12.5	7	Above	
Inflation	7.2 (<15)*	20.0	75	8.8	9	Above	
Fiscal Policy	> -3.04	> - 4.78	77	-1.072	9	Above	
Trade Policy	< 4	5.0	69	3.5	9	Above	
Regulatory Quality	> 0	-0.56	82	0.027	9	Above	
Days to start a business	< 45.5	73.3	60	30	7	Above	

*For civil liberties the MCC uses 5 rather than a 4 and for inflation 15% is used.
The cutoff for "substantially below" is 20 percent from Radelet, Brown and Siddiqi (2005).
Source: Data are from the MCA Country Ranking Dataset FY 2006.

Table 9: Summary of the Performance of the CIS as a region in FY 2005 and 2006

	FY05	**FY06**		**FY05**	**FY06**
Ruling Justly	**F**	**F**	Health Expenditures	>	P
Political Rights	<	<	Immunization rate	>	P
Civil Liberties	=	=	**Economic freedom**	**P**	**P**
Voice and Vote	<	<	Country Credit Rating	>	>
Government Effectiveness	=	<	Inflation	>	>
Rule of Law	<	<	Fiscal Policy	>	>
Control of Corruption	**F**	**F**	Trade Policy	>	>
Investing in People	**P**	**P**	Regulatory Quality	<	>
Girls Primary Completion	>	>	Days to start a business	>	>
Primary Education Expend.	>	>	**# of Failed Indicators**	**7**	**6**

Note: > above the passing score, < below the passing score, = equal to the passing score, P = passed and F = failed.
Note: For numbers, see Table 7 and Table 8 above