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Aid Selectivity and Anti-Corruption Policy: A Case Study of the Millennium Challenge Corporation

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The Anticorruption Project – Contextual Choices for Results in Fighting Corruption

The Norwegian Agency for Development Cooperation (NORAD) is a directorate under the Norwegian Ministry of Foreign Affairs, serving as a centre of expertise, quality assurance and dissemination of the results of Norwegian development cooperation. NORAD administers the agency's grant schemes in a way that development assistance, provided through Norwegian and international partners, can contribute effectively to poverty reduction. Acknowledging that recent evaluations of anticorruption initiatives have raised serious questions as to the effectiveness of the conventional approaches used to fight corruption, NORAD contracted the Hertie School of Governance to deliver a study with an outline of a typology of the corruption functions as they relate to various levels of development.

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Executive Summary

Over the last decade good governance has been widely recognized as a key determinant of development and aid effectiveness. Governance matters either intrinsically and for improvements in socio economic outcomes – Aid works best when it is target towards countries with relatively sound/or improving policies and institutions. Recognizing this, bilateral and multilateral donors are increasingly trying to direct their assistance towards recipients with these characteristics, raising a set of broad policy questions about how best to rigorously and systematically link aid policy to governance situations in developing countries.

This paper argues that corruption control is the most fundamental component of the good governance agenda, since it subverts all the other values of good governance. It is both cause and effect of inefficient and unaccountable institutions. In developing countries, were resources are scarcer and need to be used in the most effective manner, corruption is especially harmful. In an effort to clarify how this move to a more selective, performance based approach can have an influence in the control of corruption of developing countries and therefore serve as model for other donors to follow this paper will first discuss the concepts of good governance, development, corruption and review its empirical links to aid effectiveness. It will also show the benefits and limitations of measuring governance and corruption and argue for the development of more broad assessments methods.

The last part will analyze the Millennium Challenge Corporation (MCC), an innovative US agency which provides funding in accordance with the quality of governance in recipient countries to make the argument for an increase in selective allocation. Control of corruption is the most important indicator in the selection criteria and therefore we should expect the MCC to have an impact on the way recipient countries work to improve the indicator.

List of Acronyms

ADB	Asian Development Bank
AfDB	African Development Bank
CPI	Corruption Perception Index
CPIA	Country Policy and Institutional Assessment
DFID	UK Department for International Development
ICRG	International Country Risk Guide
IDA	International Development Association
IFI	International Financial Institutions
IMF	International Monetary Fund
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goals
NGO	Non-Governmental Organization
OECD	Organization for Economic Co-operation and Development
TI	Transparency International
UNDP	United Nations Development Program
WBI	World Bank Institute
WEF	World Economic Forum
WGI	World Governance Indicators
WTO	World Trade Organization

Introduction

At the end of the 1990s there was widespread disappointment with what foreign aid had achieved. Academic evidence suggested that donors had little control over how a recipient government financed its projects and that foreign aid was an incentive to corrupt practices. As a response, there has been a major research effort into aid effectiveness that led to a rethinking of practices. This research concluded that there were some systematic lessons to be learnt in respect both of the choice of recipient country and the style of relationship with the government (Collier and Dollar 2001).

Performance-based aid has been proposed as an alternative to the failed traditional approach whereby donors make aid conditional on the reform promises of recipient countries. This selectivity principle mainly consists in giving more aid to countries that have already implemented policy and institutional reforms to increase their governance. The basic idea is that governance efforts increase not only aid effectiveness but also promotes development. Several multilateral and bilateral donors such as DFDI, the Netherlands and World Bank already put in practice this principle, and many donors think about how to give more weight to good governance in their allocation procedures.

This paper is interested in understanding how a more selective approach to foreign aid can influence a better control of corruption. For this reason the Millennium Challenge Corporation (MCC) will be used as a case study. Established in 2002 to counteract these concerns in foreign aid, it has adopted an approach that emphasizes the careful selection of aid recipients, rather than the imposition of restrictive conditions on how aid may be used; and that bases its selection criteria upon publicly accessible, objective criteria, rather than a subjective or secretive process. Notwithstanding control of corruption is the most important indicator in the selection criteria and therefore we should expect the MCC to have an impact on the way recipient countries work to improve its indicator.

For a better understanding of the evolution in the foreign aid debate that led to the creation of the MCC, the first part of the paper will cast some light in the good governance discussion. The relationship between governance and development has risen up the international policy agenda, with corruption as a central pillar for good governance. There is widespread agreement that governance matters wither intrinsically and for improvement of economic and social outcomes but so far the concept of good governance remains a work in progress. The same can be said about the concepts of development and corruption. This part will also access the 2 pillars from which the MCC is based: the argument that aid promotes growth only in an environment characterized by "good" policies and institutions and the discussion on the failure of traditional forms of conditionality.

The second part will focus on corruption stressing the aid community's awareness of corruption as a factor influencing the effectiveness of aid and development prospects in general and that that aid could be more effective if it were reallocated to less corrupt recipient countries.

Finally the Millennium Challenge Corporation will be analyzed, how it is improving (or not) the control of corruption in developing countries and what it has achieved so far.

Part I - Governance, development and aid effectiveness

Good governance debate

Although the concept of "good governance" is now high in the policy agenda, its contours remain uncertain. Aid practitioners have not yet been able to articulate a clear-cut and operational definition of the concept. A multitude of definitions proposed by different International Institution and scholars, greatly differing in scope, rationale and objectives have been advanced but has also generated an increasing confusion regarding the boundaries of the concept.

Even the narrower concept of "governance" at both the theoretical and policy levels, means different things to different organizations and researchers. For example, "UNDP defines it as "the exercise of economic, political, and administrative authority to manage a country's affairs at all levels. Governance is a neutral concept comprising the complex mechanisms, processes, relationships and institutions through which citizens and groups articulate their interests, exercise their rights and obligations and mediate their differences" (UNDP 1997) while the World Bank defines it as "the manner in which power is exercised in the management of a country's economic and social resources" (World Bank 1992)

Each international organization has also developed its own definition of good governance, each in accordance with its mandates and goals. World Bank and the IMF emphasize the importance of sound macro- economic policies and the fight against corruption, while some bilateral donors and NGOs put more stress on democratization and human rights.

International community's focus on governance started in the late 1980s, after the end of the cold war when the economic breakdown of the former Soviet bloc showed the need to build institutions and recreate civil societies in former communist states. Added impetus in the discussion was given by the repeated failures to bring about development in Africa after so many structural adjustment programs by the IFI. The debate on good governance emerged as a reaction to the view that inefficient and corrupt administrative structures of developing countries were ineligible for financial loans.

The World Bank was the first major donor institution to adopt the concept in its reports. A 1989 report reflecting on the failure of structural adjustment programs to create economic growth argued that the economic crisis in Africa was a 'crisis of governance' (World Bank, 1989).

The evolution of the concept is quite extensive. In the beginning, the focus was rather apolitical and concerned the improvements in the quality of public sector management (Simonis 2004). By the mid-1990s, international donors' conceptions of good governance had widened to embrace the notions of transparency, accountability, and participation. The good governance agenda today is overwhelming. Scholars have found linkages between particular kinds of policies and institutional arrangements associated with growth and poverty alleviation and also that factors such as corruption and instability restrict development (Grindle 2004).

Good governance is now applied from 2 different perspectives. As *means* and as *goals*. In the first place it became a criterion of change in aid relationships. It is used as a mean to achieve growth or development and it is controlled in the form of conditionality (or selectivity as will be discussed below). This is not new, countries used this in the past if there were cases of human rights violation but it has recently been transformed into a broader policy tool. At the same time 'good governance' became also a goal. Development cooperation is also about building institutions, developing civil society, promoting democracy in development countries. In this sense, policies formulated to strengthen good governance in recipient countries are a goal on itself and not only a pre requisite for aid efficiency.

This lack of a clear consensus have implications in the aid effectiveness debate since one must first have a functional definition of the term in other to implement any policy intended to improve governance. It is also important when trying to measure the quality of governance in different countries for comparative analyses. The indicators available today shed light on various dimensions of governance and given the extensiveness of the concept, and in many cases the difficulty in accessing all its aspects, today there is not a single indicator or a combination of indicators that can provide a clear and reliable measure of governance as a whole.

However, the existence of different concepts should not be overstated. While the many definitions of governance preferred by different institutions and countries vary to some degree, they do convey the notion that the quality of institutions and good and transparent public management is fundamental to developing countries. In general terms, 'good governance' means developing institutions and processes that are more responsive to the ordinary citizens, including the poor. It implies the promotion of participation, accountability and effectiveness at all levels. Moreover this lack of consensus leaves open a window of opportunity to adapt the concept to different country realities. It will be emphasized in this paper that the concept can only be used effectively when cultural context and history are understood and thoughtfully taken into account.

Governance indicators

If the quality of governance is important for policymaking, access to reliable, valid and comparable data is crucial. Data must be able to capture a country's past performance, its present trends and reforms (or lack of it) and indicate the amount of change within certain periods. Better information can provide a basis for understanding the context to which policies will be implemented and identify the main challenges and windows of opportunities.

Due the recent increased debate about good governance several datasets with governance indicators have emerged. A vast variety of sources access many aspects of governance, encompassing different countries and regions and different periods of time.

Following Kaufmann and Kray (2008), indicators can be categorized highlighting differences in focus, type of information used, the source relied upon and the construction of the index itself. The first distinction concerns rules-based and outcome-based indicators of governance. The rules based approach would focus on the existence of certain types of legislation or institutional settings. Thus, for instance, a rules-based indicator of corruption might measure whether countries have legislation prohibiting corruption or have an anticorruption agency, whether the outcomes based would access if the anticorruption agency is undermined by political interference or exhibit data on the number of legal prosecutions for corrupt acts.

Arndt and Oman (2006) give two reasons why perceptions-based indicators are of particular more importance in developing countries then facts-based (rules based) indicators: a) the data required to construct facts-based indicators are often lacking, or lacking credibility and b) the gap between the de jure facts which facts- based indicators often use and the informal, largely unwritten, institutions which they tend to ignore but often weigh much more heavily in de facto governance realities in developing countries, means that facts-based indicators can be seriously misleading. Thus, for example, the existence of specific anti-corruption laws does not necessarily imply lower de facto corruption in one country compared to another that does not have those laws.

Another differentiation regards objective and subjective criteria. The subjective criterion is the information based on the perception of different stakeholders. Dividing this further, we have expert versus survey-based indicators. Governance indicators derived from surveys of firms and individuals captures the views of the ultimate beneficiaries of good governance: citizens and firms in a country. The views expressed by thousands of domestic stakeholders provide powerful input for any policy reform. If the perception by firms or individuals is that the courts and the police are corrupt, they are unlikely to try to use their services, presenting an urgent target for policy reform.

Finally, regarding the construction of indicators, they can be distinguished between individual and aggregate. Aggregate indicators are a useful way of combining, organizing, and summarizing information from different sources, thereby reducing the influence of measurement error in any individual indicator. Although aggregating indictors gives rise to methodological issues, aggregation also allows for the construction of explicit margins of error for both the aggregate indicator and its component individual indicators.

While most indicators of governance have many virtues, all face distinct challenges. Even the most carefully constructed of these indicators lack transparency and comparability over time, suffer from selection bias, and are not well suited to be the only measurement to help developing countries identify how effectively to improve the quality of local governance. Policy makers tend to use, and widely misuse, these indicators to compare the quality of governance both among countries and over time. When assessing governance across countries, within a country, or over time, a variety of indicators and sources must be used for a more reliable judgment.

The perfect governance indicator will undoubtedly never exist. No existing measure of governance can capture all of the impact suggested by theory. Still, the production and use of more transparent governance indicators will better serve the needs of both external users and developing countries seeking to improve the quality of local governance.

Measuring corruption

Corruption, as will be discussed in the next session, acquired an increased importance in the development agenda and thus generated a strong demand for reliable indicators. Several indexes were developed recently providing a better understanding of the phenomenon. Nevertheless, unlike other aspects in international development, corruption proved to be a much more difficult framework to assess.

This session is not intended to present all the alternatives for measuring corruption nor all the setbacks of the several indicators but to briefly analyze the two most commonly used indicators, namely Transparency International's Corruption Perception Index (CPI) and the control of corruption indicator of the World Bank Institute's World Governance Indicators (WGI) and to shed some light in the major challenges these measurements present to make an argument for the development of a better instrument for policy analyses in the last session of this paper.

Both CPI and WGI are composite perceptions based indicators meaning that they capture only *perceptions* of corruption in a country instead of the actual level of corruption. They are based on experts,' firms' and peoples' perceptions and assess a wide and differing range of corruption (UNDP 2007, Knack 2006). In 2008 the CPI was calculated from a small set of data from 11 different organizations. The WGI Control of Corruption indicator used these 11 data sources from the CPI, as well as 14 others not used in the CPI.

The WGI measures six dimensions of governance (i) Voice and Accountability, (ii) Political Stability and Absence of Violence/Terrorism, (iii) Government Effectiveness, (iv) Regulatory Quality, (v) Rule of Law, and (vi) Control of Corruption. It covers 213 countries between 1996 and 2009. They are based on hundreds of specific and disaggregated individual variables measuring various dimensions of governance, taken from 35 data sources provided by 33 different organizations (Kaufmann 2009). The CPI nevertheless measures only corruption.

Despite major improvements in corruption assessment in recent years, measurement is still facing several obstacles. Here 3 important concerns will be highlighted (i) the perception problem / actionable problem (ii) the comparability problem and (iii) the error problem.

First, it is necessary to point out that there is no international consensus on the meaning of corruption. Because of the many different faces corruption can get and its very nature, it is almost impossible to develop a precise and objective measure of its occurrence. This ambiguity has direct implications on any corruption index and rank. Besides the inherent measurement problems in any social research (e.g. sampling error, operationalization problems) corruption has an intrinsic component that also leads to error: the very nature of corruption appraisal or an error relative to the very concept that is expected to measure (Kaufmann and Kraay 2007).

In aggregated corruption indices, such as WGI and CPI, this problem is even more accentuated given that it is not always clear what each of the different indicators used in the aggregated indices really measures, because the types of corruption and their meaning vary from one country to the other and from different sources used (Thompson and Shah 2008, Lambsdorff 2007, Knack 2006). Sources tend to capture several dimension of corruption and therefore indices represent a bigger picture of corruption, making it hard to be transformed in operational tools for concrete anticorruption efforts.

Besides, the methodology used and the changing composition of these 2 indicators over time further mean that they cannot be used reliably to compare levels of corruption (and governance for the WGI) over time, be it in a given country or among countries. The reason is that the composition of the samples changes every year. Changes in the country's scores on CPI or WGI could be driven by adding a new source to the index or dropping an outdated one. Each source has its unique scaling system.

Since its launch in 1996, WGI have increased the number of sources used over time with the intention of decreasing bias towards a single source, expanding therefore the dataset base. Invariably, as new sources are added, the index definition is distorted and makes inter-year analysis less reliable.

Paraguay, serves as an illustration of this setbacks. In 2003 it had only 3 sources (ICRG, Latinobarometer and WEF) compared to 11 in 2009. This shows the difficulty of measuring the indicator across time. Besides, the argument of difference in perception of corruption among sources is evident in the analyses of sources in 2003. ICRG for instance measures mostly the perception of corruption by business firms and the payment of bribes while Latinobarometer is a household survey. The different understanding of corruption is such that in 2003, ICRG graded Paraguay 0.17 while Latinobarometer 0.80.

Finally, the margin of error of the indicators is still very high. Kaufmann and the co-authors of the WGI explicitly caution against using their indicators for ranking purposes because of the embodied measurement errors (Kaufmann et al 2005). However, it is important to acknowledge that WGI indictors are weighted in a manner that makes it possible to construct confidence intervals around the point estimate. As such, the indicators take into account the inherent uncertainty about any governance indicators and also take into consideration that the various sources give an imprecise estimate of the relevant governance dimension being captured. For this reason, when comparing scores over time, if the change in or difference between scores is large enough that the scores confidence intervals do not overlap the change can be considered meaningful. (see Figure 1 in the appendix) (Maurseth 2008, Arndt and Oman 2006). CPI also reveals its margin of errors.

Since all quantitative indicators present not only several gaps but are not able to point the causes of corruption in a given country any diagnosis of corruption needs to include both qualitative and quantitative elements. Qualitative instruments such as representative surveys are more reliable for an analysis of the causes of corrupt behavior while quantitative will provide figures on its extent (Mungiu Pippidi 2006). Nonetheless, so far, the qualitative information needed to inform operational work has remained scant. There are as yet few frameworks offered for collecting such information in a systematic way.

Development and good governance

Economic growth is only one aspect of development; another key dimension of development is the expansion of the administrative capability of the state, the capability of governments to affect the course of events by implementing policies and programs. (Pritchet et al 2010)

In the last decade development policy had an important turning point; the basic objective of development as a policy to induce growth (usually measured only on GDP growth basis) has been replaced by the objective of poverty reduction (World Bank 2000), meaning that for most donors growth in the developing world is only valuable if it can be construed as pro-poor. This represents a noticeable difference from conventional definitions in that it does not mention only income or expenditure but focuses on wellbeing as important outcomes as revealed for instance by nutritional and health status and educational attainment. Income is also important for the realization of these objectives, but should not be view as a solely policy outcome objective.

In fact, per capita GDP measures neither the quality of life nor is an end in itself. It is only considered as a mean but the end of development is the welfare of human beings. The emphasis by the donors agencies in the reduction in the global poverty headcount through economic growth lead to poor program selection and consequently poor design and implementation, and it has often undermined the effectiveness of aid. For this reason, the emphasis has now shifted to multidimensional understanding of human development, which ensures an overall development of human beings and the society and plays a key role in the development process.

This idea has been largely constructed from the influential work of Amartya Sen (1999) in which the definition of poverty is in terms of “capabilities”. Sen understands as *capability* the substantive freedoms people enjoy to lead the kind of life they have reason to value, such as social functioning, better basic education and healthcare, and longevity. Poverty is not just a matter of being economically deprived, it is defined and sustained by a sense of helplessness, dependence and lack of opportunities, self-confidence and self-respect on the part of the poor.

This discussion is not only academic. The World Bank study Voices of the Poor highlights powerlessness and lack of voice as crucial components of poverty as stated by the poor themselves. Similar finding were obtained at the Gallup Millennium Survey where people from developing countries stated the importance of human rights (Court et al 2004).

Sen's ideas provide a toolbox of principles for a development approach with a more flexible framework allowing policy-makers to better analyze the diversity of challenges that poor people and poor countries face, and implement policies in accordance with this needs rather than imposing a rigid set of policy prescriptions.

This new components of development were also encompassed in the good governance agenda. Once development is understood in this broader sense, good governance can be both the means and the goal to achieve a higher rate of development in any country. According to UNDP (1997b), the result of good governance is 'which gives priority to poor, advances the cause of women, sustains the environment, and creates needed opportunities for employment and other livelihoods'. If development is pro poor, it will bring inclusiveness and opportunity to more people and this is the intrinsic value of good governance *per se*. For this reason, good governance should be pursued in all dimensions as a basic development goal.

When donors focus on just one dimension of poverty reduction (growth) they leave behind other legitimate objectives such as reducing chronic diseases or providing basic social services in countries that cannot otherwise afford them. Aid agencies must recognized this objectives and access its incentives. The debate about aid effectiveness would be not only more inclusive but more proficient if there were greater recognition of the different dimensions of poverty reduction. As we will demonstrate, the MCC took an important step in acknowledging some of these issues in its eligibility criteria.

Assessing aid effectiveness

The debate about the impact of foreign aid has long been a strongly contested subject. Since the 1970s, several empirical studies relating aid and growth started to be conducted, setting off a vast controversy, which remains until the present. As pointed out by McGillivray et al (2005), research up until the 1990s was either of the "It Works or It Doesn't". Some studies found that aid was associated with higher growth, other found the opposite and no consensus was achieved. The common understanding was that there was a micro-macro paradox in aid (Mosley 1997, Boone 1994). It was said impossible to establish any significant correlation between aid and growth. However, at a micro level, all donor agencies attested success of most of their projects and programs.

The research on the conditions for aid to work on the macro level started with a very influential paper form Burnside and Dollar (1997), arguing that aid works in a good policy environment. Openness to trade, low inflation, and low government budget deficits was used as definition of "good policy". In 1998, the World Bank, based on the data set and earlier analysis of Burnside and Dollar (1997), published a report that became the watershed in the aid effectiveness debate: *Assessing Aid: What Works, What Doesn't and Why*. The main argument was that the impact of aid on growth depends on "sound economic management" and effective institutions.

It went further to endorse a selective approach to the disbursement of aid based on policy performance and reform commitment, rather than on the extent of poverty or developmental needs of a borrowing country. The report also called upon the Bank to give more financial resources and expertise on governance issues for realizing development goals. If accurate, these findings provided a key selectivity test with which to distribute future aid. While other economists worked to test the validity of these results, politicians quickly embraced the findings and their impacts on foreign aid policies. Institutions such as the Millennium Challenge Corporation (MCC) were created to use this selective approach towards foreign aid allocation. Other multilateral and bilateral donors started to recognize the importance of this finding as well and are now moving towards new policies (World Bank 1998 and 2002, USAID 2004, DFID 2000).

At the research community *Assessing Aid* has provoked a lively reaction. Several important rebuttals surfaced when researchers tried to redo the econometric analysis of the Burnside and Dollar paper and contested its robustness in several dimensions. A few studies attempted to prove the point that aid was effective in all policy environments, not just good ones (Dalgaard and Hansen 2001, Hansen and Tarp 2001). Others sought to disprove the conclusions (Jensen and Paldam 2003, Islam 2002, Ram 2004, Easterly et al 2003, Rajan and Subramanium 2005). Finally, important studies found support for the Burnside and Dollar result (Collier and Dehn, 2001, Collier and Hoeffler, 2002 and Collier and Dollar, 2002).

It is important to notice that most of the academic debate has focused merely on the relationship between aid and economic growth. Such a narrow focus fails to capture other dimensions of poverty and therefore fail to access an important component of aid effectiveness. For this reason, it is a good attainment that recent aid effectiveness literature is using welfare indicators instead of GDP to access impacts.

This is the reflection of increased emphasis being placed on poverty reduction in policy circles, and of the debate about further increase in aid to poor countries (for example, the UN Millennium Project (MDGs) and the report of the Commission for Africa). Mosley et al (2004) in one of the first papers seeking a change in focus expressed that "What further differentiates our paper from both the other contributions is our focus directly on poverty, while assuming an effect of aid on economic growth; whilst other papers have focused on the impact of aid on growth while taking the impact of growth on poverty as given and automatic".

Another important distinction regards studies that differentiate types of aid. As well as moral and humanitarian motives, countries give aid for a variety of commercial, strategic, and political reasons. Therefore, a significant portion of aid is not aimed at stimulating economic growth. Aid for humanitarian assistance, disaster relief or health are not aimed primarily at growth. Hence, studies that examine the relationship of all aid and economic growth without making this distinction may be misleading.

A recent study by Clemens et al (2004) is a pioneer in this regard. They divide aggregate aid into categories: “short-impact”, “long-impact”, and “humanitarian”. Focusing on “short-impact” aid they find a positive causal relationship with economic growth. Their aid variable includes budget and balance of payments support and aid for infrastructure and industry, all of which can fairly be expected to affect economic growth within a few years. The argument to leave out other kinds of assistance is that this kind of aid show up in GDP only after a generation, and is harder to detect.

The link between quality of governance and aid effectiveness

In an article revisiting their original work Burnside and Dollar (2004), defend the link of good governance and aid in a simple statement: “We found these results quite intuitive: a corrupt, incompetent government is not going to use aid wisely and outside donors are not going to be able to force it to change it habits.”

This illustrates that fact that the aid effectiveness debate reached an agreement that aid works even though, its impacts differs across countries depending on the conditions they face. Better policies, however defined, should in all probability result in more effectiveness. Aid might help spur growth in countries with reasonably good economic policies, but might fail to do so where corruption is rife and the economy is badly mismanaged (Radelet 2006). Accordingly, the recent debate is directed to understand which of the several good governance dimensions matter foremost, what are the precise casual linkages and pathways of improving governance and economic growth. This debate is characterized by a lack of consensus and leaves a vacuum of guidance in the policy world, about whether and where aid is likely to work.

A growing body of empirical research supports the pivotal role for institutions in development (Acemoglu et al 2001, Rodrik et al 2004). These studies usually find that non- transparent, unaccountable, and restricted governance is detrimental to development and welfare, while the opposite tendency is advantageous (Kaufmann et al 2005). However, other studies point to influences other than policy variables such as geography, climate, political stability, per capita income and the extent of poverty within a country (Ridell 2008).

This leads to the conclusion that while some of the good governance components are crucial for development a better understanding of all the local underlying conditions is just as important for a full absorption capacity of aid funds. In this context donors are currently defining their policies and interventions based on selectivity and experimenting several good governance criteria. New research and new datasets on this direction are playing an increasingly important role for a better understanding of the task.

Conditionality and selectivity - Ex-ante conditions or ex-post rewards?

As mentioned, the main policy implication of the Burnside and Dollar (1997, 2000) findings was that many donors reformed their approach to conditionality to adopt some kind of selectivity in their aid allocation.

As captured by Jonhson and Zajonc (2006) “Conditionality is a set of requirements, determined in the grant or loan agreement, which must be implemented prior to further disbursement of the loan or grant.” From this prospect aid is disbursed once recipient governments agree to implement reforms deemed necessary by donors, (often fight corruption is among the demands).

Several recurrent themes shaped the critique of conditionality. The most sweeping element of the critique was that donor- supported reforms were poorly adapted to the specific situation of each developing country. As stated by the World Bank (2000) “Donors come to development problems with their own mandates, histories, ideologies, and political realities and often do not see situations in the same way as other donors or the recipient countries.”

A second critique is related to what *kind* of conditionality was used. It is not always clear what policy conditions are the most appropriate to ensure sustained growth and development. The conditionality of the IFI’s structural adjustment programs of the 1980s and 1990s for instance has been highly criticized and these programs were blamed to have caused a worsening of social indicators, with little effects on stabilization and economic growth. Moreover, this top down approach, with donors telling countries what reform to do raises the question of who should bear the costs if conditions make things worse? Conditionality makes governments less accountable for their own failures, or as Collier (1999) argues “conditionality is often dysfunctional because it implies a transfer of sovereignty that undermines the domestic political process.”

In addition, the conditions imposed generated a conditionality that was dissonant, lacked credibility, and encouraged recipient governments to accept impositions in order to obtain money even when they were not convinced that the agreed economic policy reforms were useful, or having any real intention of implementing them (Adam et al, 2003). This lack of political support leads to lack of compliance. Evidence shows that there is little relationship between aid flows and changes in policy. Donors have at times repeatedly imposed the same reforms from recipient countries, paying for reforms that never materialize or that are soon reversed. At the same time, breach of promises was rarely sanctioned by donors. In fact the only time the World Bank opted to enforce the rule was in Senegal in the 1980s (Mosley et al 2004). In Kenya, for example, the World Bank provided four agricultural adjustment loans during the 1980s and 1990s based on government promises to implement the same basic set of reforms. Each time the government implemented the reforms, took the aid, and reversed the reforms right after (Svensson 2003, Radelet 2005).

This dynamics between aid donors and recipients shows why conditionality fails: Recipients do not see the conditions as binding, and most donors are reluctant to stop giving aid when conditions are not met resulting in a low compliance while the release rate of loan tranches remains high (World Bank 2000). Because aid continues continue to flow bad policies are perpetuated.

All these circumstances gave rise to a "new aid paradigm" that was expected to raise aid effectiveness. In response to the lack of effectiveness of policy conditionality, donors began to stress the need for selectivity in the aid allocation, only providing aid to countries with proven good policies and good governance (Dijkstra 2010).

The main proponents of performance-based allocation aid were Collier (Collier 1997, Collier et al. 1997) and Svensson (2000, 2003). The authors called for a fundamental change in donor behavior to reward reform-minded recipient countries. Aid allocation would be based on retrospective performance appraisals, rather than being conditional on reform promises. This proposal altered the conditionality debate completely. The provision of aid won't be based on a promise but allocated to countries that have either implemented key reforms or showed sufficient commitment to it. In line with Radelet (2005) "In the language of the principal agent problem, donors should spend less time trying to write contracts that force an alignment of incentives and instead give more aid to countries that on their own demonstrate similar motivations and objectives."

Collier et al (1997) pointed also for another significant benefit of selectivity. It could have the effect of *signaling* that the country is safe for investment. Since the selectivity process only give grants to countries that are able to perform the reforms themselves or to commit to long term reforms, the signature of a grant could work as "seal of approval" from the Donor institution. This would stimulate investment by reducing private sector decision costs. Private investment is sensitive to a whole range of policies and commitment mechanisms that developing countries lack. African governments for instance are not members of the WTO and their central banks are not sufficiently independent to provide credible fiscal and monetary discipline.

Using a different range of measurement tools, a number of donors already consider governance issues to inform their allocation across countries (Guillaumont 2008, Court et al 2007). The World Bank uses the Country Policy and Institutional Assessment (CPIA) for IDA funds. To some extent, several other formulas, in particular those of multilateral development banks (AfDB, ADB), replicate that of the World Bank. Some bilateral agencies also use the CPIA as part of a model to inform their aid allocation, such as DFID and the Netherlands.

In sum, we can conclude that the traditional punitive form of conditionality is not an effective method to incentive reforms or to achieve good governance in developing countries. What is needed is a more balanced mechanism, letting development countries exercise greater control over the use of foreign aid, within a framework of agreed-upon objectives. The incentive aspects of selectivity and the emphasis of a greater ownership of reforms in recipient countries should receive more attention by all donors.

As stated by Santiso (2002), "External support to policy change has all too often failed to offset a lack of local commitment and ownership of reform. The use of financial leverage is not a substitute for weak domestic institutions or feeble political will and can instead further delay necessary reforms." For this reason, Performance-based aid represents a promising alternative for reforming the governance of aid. Donor agencies must actively support this innovative and comprehensive approach to development.

Part II – Corruption

Corruption: a threat to development

Until last decade, corruption was seen as a regular part of public life in many countries. It was mainly understood as part of a political culture or a natural component of human nature and there was no open debate about its consequences or about any kind of control. Discussions were limited to academic circles and were marginal.

This picture radically changed recently, corruption became one of the most important dimensions of the good governance agenda and is now a growing concern in national and international politics. Discussions are no longer theoretical but based in empirical evidence acquired through comprehensive datasets, and measure and analyze the different perspectives of corruption.

This paper argues that corruption control is the most fundamental component of the good governance agenda. Although, to be operational the concept of good governance must be adapted to the reality of each country and there is no point of establishing a fixed box of tools or prioritizing one aspect of governance over the others, corruption has a different “status”.

Like other components of good governance, corruption is an impediment to development and growth. But it has a more immediate decreasing effect on the impact of aid or reforms since aid administration and aid projects themselves are challenge by corruption. No reform or development project can have a high absorption rate if corruption is high. Since corruption subverts the values of good governance a strategy to curb it is a fundamental aspect of policy development. This paper in concerned with the role of corruption and good governance in foreign aid, but the rationale can be expanded to local projects conducted by national governments without foreign money.

The analyses of the impact of foreign aid in anti-corruption can be developed in 2 different paths. The first concerns the questions: How foreign aid can be more effective in fighting corruption? What are the strategies and tools that donors can offer to countries that show commitment to curb corruption?

On the other hand there is a discussion about how to make aid itself less subject to corruption. Studies reveal that foreign aid foster corruption in recipient countries. In accordance to Knack (2000) “Aid dependence can potentially undermine institutional quality, by weakening accountability, encouraging rent seeking and corruption, fomenting conflict over control of aid funds […] and alleviating pressures to reform inefficient policies and institutions.”

The main focus of the following analyses will be the first aspect, meaning, how to make aid more effective in the control of corruption, but the argument that aid weakens national control mechanism in recipient countries will also be analyzed in the discussion of the necessity of a greater accountability of projects by recipient countries in the case study of the MCC.

Is corruption “a grease on the wheels” for economic development?

The increase of empirical research addressing the economic impact of corruption promoted a better understanding of the economic distortions caused by corruption. Notwithstanding, some research still defends the beneficial effects of corruption, the so-called "grease the wheels" hypothesis. Put forward by Leff (1964), Huntington (1968) and Leys (1965), that hypothesis suggests that corruption may be beneficial in a second best world because of the distortions caused by ill-functioning institutions. The argument is that an inefficient bureaucracy constitutes an impediment to investment that some "speed" or "grease" money may help circumvent (Meón et al 2008). Corruption could have positive effects, under certain circumstances, by giving firms and individuals means of avoiding burdensome regulations and ineffective legal systems.

But this argument ignores the enormous discretion that many politicians and bureaucrats have (even higher in corrupt societies) over the creation and interpretation of counterproductive regulations. Corruption and inefficient regulation are two sides of the same coin. On the one hand, inefficient regulation is needed to generate scarcity rents. On the other hand, scarcity rents create corruption potential because individuals are willing to pay (for licenses and other government policies) only if there is scarcity. In other words, the corruption potential that such regulations have is what make them to be put in place and cause the distortion. As a consequence, even if corruption helps overcome the cumbersome regulation in the short term, it creates incentives to create more such regulation in the long term perpetuating the system (Aidt 2009).

The argument that bribery can enhance efficiency by cutting down on the time needed to process permits follows the same line of reasoning. The possibility of bribery may be what causes the process to slow down in the first place. Available empirical evidence refutes the grease and “speed money” arguments by showing a positive relationship between the extent of bribery and the amount of time that enterprise managers spend with public officials (Gray and Kaufmann 1998)

Kaufman and Wei (2000) tackled the issue from a different angle. Using firm-level data, they tested whether corruption reduces the time that firms spend negotiating with foreign countries' officials. They found that multinationals that pay more bribes also tend to spend more time negotiating with foreign countries' officials, which contradicts the "grease the wheels" hypothesis.

Contextualizing Corruption

Just like the concept of good governance, the concept of corruption is also broad and encompasses several dimensions. Besides, corruption in developing countries is not the same phenomenon as corruption in developed countries. While in developed countries corruption often designates individual cases of infringement of the norm of integrity, in developing countries corruption is a collective action problem. In such societies governments have never reached the impartiality, impersonality and fairness that presumably characterize modern bureaucracies. For this reason this societies are classified as “particularist” societies - a mode of social organization where public goods are distributed on a non-universalistic basis (Mungiu Pippidi 2005, 2006).

In developed countries corruption is seen as “principal agent” problem. This can be presumed by the most common definitions of corruption “the use of a public position to seek personal gain” or Klitgaard’s definition - “Corruption tends to emerge when an organization or a public official has monopoly power over a good or service that generates rent, has the discretionary power to decide who will receive it, and is not accountable” - Corruption = Monopoly + Discretion – Accountability (C=M+D-A) (Klitgaard 1988).

Both definitions ignore the collective action problem character present in some countries context. This shortcoming of the definition has direct impact into policy mechanism used to curb corruption. For instance, in so far corruption is the expected behavior in a particular society we should expect monitoring devices and punishment regimes (such as recommended by a strictly principal agent approach) to be ineffective simply because there are no actors willing to enforce them (Personn et al 2010). Or, as captured by Mundiu-Pippidi “Particularism cannot be fought by government—that is a contradiction in terms.”

The factors that cause corruption are country specific. Approaches that apply common policies and tools to countries in which acts of corruption and the quality of governance vary widely are likely to fail. Policy makers need to understand the local circumstances that encourage or permit public and private actors to be corrupt (Shah 2007).

Good governance and corruption - What impact does corruption has on growth and development?

Corruption is related to governance since it is a symptom of severe institutional weaknesses. It is both cause and effect of inefficient and unaccountable institutions. In developing countries, were resources are scarcer and need to be used in the most effective manner, corruption is especially harmful.

Looking at poverty from a *capabilities* perspective, it can be argued that corruption contributes directly to poverty by depriving the poor of public services and benefits that deny them political, social and legal rights and by distorting development priorities. Instead of looking at government as an enabling institution, the poor see it as oppressive and their sense of powerlessness and exclusion is reinforced.

Several studies show that corruption worsens income inequality and poverty, increases the managerial and financial costs of doing business, reduces investment rates, lowers economic growth, diminishes democratization and weakens representation. Corruption thus enervates the economy and plainly promotes poverty (Bhargava et al 2001).

More generally, the distortions corruption may create in the economy have a disproportionate effect on the poor. In particular, 'corrupt officials distort public sector choices to generate large rents for themselves', resulting in 'too many of the wrong kind of projects' (Rose-Ackerman, 2002). Same reasoning can be found in Mauro (1998), corruption affects the composition of government expenditure. When corruption is serious, there is much less government expenditure on education than on large infrastructure and defense projects. In addition, he points out that corruption not only shifts priorities but also lowers the quality of infrastructure projects and public services.

Distortions in public spending arise in three ways: from shaping the official priorities of government, by deflecting allocated resources away from their original purpose, and by undermining the tax base of government. Priorities are distorted and public resources deflected in corrupt regimes, because allocations go where corrupt officials and politicians personally gain the most. The public interest is no longer the measure. Where corruption is rife, even necessary projects, no matter how supportive it may be of public goals of growth and development, can go astray because it does not serve the interests of public office bearers who want to enrich themselves (Heymans, and Lipietz 1999).

Clearly controlling corruption therefore promises to yield significant improvements in the quality of life of afflicted countries. To control corruption is, therefore, to fight poverty and to promote economic development. Policies that reduce corruption will also lower income inequality and poverty. (Gupta et al 1999)

Corruption and foreign aid

Academic literature refers to the speech of World Bank President James Wolfensohn's in September 1996 as a benchmark in aid community awareness of corruption. (Gray and Kaufmann 1998, Easterly 2007). At the occasion Wolfensohn highlighted corruption as a major impediment to effective aid and economic development, declaring that for developing countries to achieve growth and poverty reduction, "we need to deal with the cancer of corruption." Since then, fighting corruption has moved to the forefront of all development agencies and several of then institutionalized its anti-corruption strategies in this period.

Several academic studies tried to understand the relationship between aid and corruption, to see whether or not foreign aid promotes a decrease in corruption. (Svensson 2000, Tavares 2003, Knack 2001, 2004). An increase in any official development assistance (ODA) pre-1997 is associated with higher levels of corruption or has no impact at all. (Charron 2011).

Knack (2001) examined aid and governance quality (using ICRG dataset), finding a significant, negative relationship between the two, among all recipient nations for the period

1982–95. Alesina and Weder (2002) also find no evidence that corruption negatively affects the amount of foreign aid, meaning that efficient and honest governments have never been rewarded by more bilateral or multilateral aid during the studied period (1975-1994). In the case of United States they actually find a positive relationship between corruption and aid. They also argued that continuous aid inflows only led to further corruption, eroding governance and perpetuating the need for aid in a vicious cycle.

More recent studies are now separating data from before and after the start of the anticorruption movement. The justification is that not only an awareness of corruption increased but also, the end of the Cold War allowed the U.S. and other donors to more selectively target aid, rather than using aid to strengthen corrupt but strategically important autocracies. (Knack and Rahman 2007). Charron (2011) using data from 1997 onward argue that the impact of multilateral aid is strongly and robustly associated with lower corruption levels, while bilateral aid is shown to be an insignificant determinant.

Easterly on the contrary, shows that in the late 1990s and early 2000s, the share of aid going to corrupt countries increased, showing that donors do not seem to react to changes in the level of corruption, but simply continue giving to the same countries. “The bottom line is that there is evidence for some sensitivity to corruption, but there is no evidence for learning by the aid agencies in response to new emphases in the literature about corruption” (Easterly et al 2008, Easterly 2007).

This debate was not limited to the academic circle. There is a growing public perception that aid money is squandered by corrupt governments. As an example, 52% of respondents to a UK survey believe that corruption in poor countries makes it pointless donating money to reduce poverty (OECD 2010). Public mistrust of aid was aggravated by the global economic crisis. With the emergence to trim the budget in the developed world there was an increased level of scrutiny over the use of public funds so any increase in corruption could lead to calls to cut aid.

Concomitantly the international community expanded the aid agenda. The MDGs and similar initiatives pushed for an increased amount of transfers. This scaling up of aid created an even greater emphasis on aid effectiveness, accountability and transparency.

Foreign aid and corruption control

Foreign aid and control of corruption can be studied from the perspectives of a programmatic approach, it means, the tools and strategies donors have to curb corruption. This type of program is still a work in progress with donors experimenting different strategies and approaches. But it also refers to the sanctioning and incentive mechanism that donors must present to corrupt governments before they give money to any kind of development project.

The focus of this paper is the second perspective. Sanctioning governments by withdrawing aid or rewarding countries with good performances in a given set of good governance indicators are legitimate policies, based on the concept of efficient allocation of resources and must be implemented with more emphasizes by the international community. However, recipient countries with poor governance indicators but seriously committed to reforms also need international support. The rationale behind this argument is that political will to fight corruption is the most important point of departure: anti-corruption reforms have a higher chance of success when they are implemented by a leader committed to overcome bureaucratic resistance and inertia.

But even well-meant efforts are unlikely to meet their goals if basic democratic institutions — from judiciary systems to a civil society — are not in place. The great majority of developing countries, lack these political and economic institutions. This is not surprisingly since by definition (as they are developing countries) they have not got the institutions critical to ensuring sustainable growth.

Since corruption became central on the international agenda several presidents in developing countries have been elected on an anticorruption platform. However, as the case of Paraguay demonstrates (see Appendix), results do not appear immediately and setbacks are common (especially when rent seeking structures remain strong in the opposition party). This is because the change of institutions and attitudes of the society as whole is a gradual and slow process. Alongside, the renewed political will for change increases potential whistleblowers and the number of cases seems to increase as result. This paradoxical situation could lead to discredit of the new government and diminish incentives for reforms. For this reason, external expertise and financial resources to strengthen governance are crucial.

Part III - The Millennium Challenge Corporation

The Millennium Challenge Account

The Bush administration came to office in the middle of a change in paradigm in foreign aid, due the poor track record of past aid programs the prospects for aid funding in US appeared grim. During the campaign the Republican Party criticized foreign aid as wasteful and unproductive arguing for more open markets in trade and investment and not an increase in foreign aid (Clancy 2004).

However, after September 11th, 2001 and the policy of war on terrorism the administration understood the necessity of creating a new foreign aid initiative. The widespread idea was that problems and discontent in other parts of the world could produce dire consequences at home. On the eve of the U.N.'s Financing for Development Conference in Monterrey, Mexico, in March 2002, contrary to all expectations of no further increase in development aid, President Bush announced the Plan for the creation of the Millennium Challenge Account (MCA), and proposed a 50% increase in aid, the largest in decades This new development fund was initially announced as $5 billion per year of additional funding.

New development assistance nevertheless, would target countries not by need alone or geopolitical considerations but would focus at countries that met a series of economic and political criteria that centered upon "good governance".

At the announcement President Bush told delegates that the US would commit to a new "transformative" program providing funding to nations that are "ruling justly, investing in their people, and establishing economic freedom". This shift in focus had the intention of countering the arguments that aid had been ineffective. By tying aid to the performance of recipient governments, the president, argued that good policy performance would produce more effective aid. "Sound economic policies unleash the enterprise and creativity necessary for development. So we will reward nations that have more open markets and sustainable budget policies, nations where people can start and operate a small business without running the gauntlets of bureaucracy and bribery" (Bush, 2002).

The MCA can be the way toward a fundamental improvement in foreign aid if its innovative methods heads to more effective results and could also be a model for other donors. It is the first official recognition that at least part of the explanation for foreign aids limited impact lies with the donors and the way they administer assistance programs (Easterly 2000).

The Millennium Challenge Corporation - MCC

When announcing the MCA President Bush's did not specify where it would be located bureaucratically. Three alternatives were explored: giving USAID responsibility for administering the MCA, creating a new office within the State Department to administer it, or creating an entirely new aid agency. The third option was chosen, and special-purpose government corporation was created to run the program, the "Millennium Challenge Corporation" (MCC). (Lancaster 2008, Rieffel and Fox, 2008)

The reason for the creation of the MCC was to prevent institutional legacies from undermining innovative allocation rules. Three distinct advantages are associated with this form: it is free from most of the plethora of legislative requirements imposed on other vehicles; it is free from country earmarks; and it is free from the obligation to commit funds in the year they were appropriated (Rieffel and Fox, 2008).

USAID is often criticized for its highly bureaucratic nature and competing self-interests. Moreover, the United States' extensive practice of Congressional earmarking has forced USAID to allocate funds for politically popular programs, such as disaster relief, instead of entirely allowing USAID the freedom to determine on its own which programs need funding (Nakagawa, 2005). An additional innovation included the ability of recipients of MCA funds to purchase goods and services from providers outside the United States. (USAID funding was estimated to be around 70 percent tied to U.S.-produced goods and services in the Clinton administration; the percentage of tied aid is no longer published (Lancaster 2008).

Decision of aid allocation by the MCC is taken by its Board of Directors that consists of the Secretary of State, the Secretary of the Treasury, the administrator for USAID, the chief executive officer of the MCC, and the U.S. Trade Representative. Four other members on the Board are selected by the President from a pool of individuals nominated by the minority and majority leaders in both houses of Congress (Millennium Challenge Act of 2003).

Principles

MCC's founding documents articulate three core principles reflecting the lessons previously learned by the development community: (i) sound policies matter for economic growth, (ii) country ownership is critical to sustainable development, and (iii) aid should be delivered with accountability for results (Phillips-Mandaville, 2009).

The first principle links good governance and economic growth. From the official goal of the MCC - to reduce poverty through the promotion of sustainable economic growth – we can see that although the lack of consensus about link of economic growth and foreign aid, MCC still pursues GDP growth as the main policy outcome. The fact is that MCC was highly influenced by the studies of Burnside and Dollar and further research on this regard. The components of good governance selected by the corporation are characterized by the eligibility criteria and will be discussed below.

Country ownership is based on the idea, well discussed by the Donor community that recipient countries must be able to control the prioritization process. Only trough effective participation and meaningful ownership by the recipient government and the people in the recipient country, development aid can accomplish its objectives. (Nanda 2006).

MCC leave it to each partner country to identify its own priorities for removing constraints to economic growth and poverty reduction, and to propose specific programs based on those priorities. Once countries are named as “eligible” by the MCC they must then consult with civil society and government groups in order to submit a proposal to the MCC for funding. Successful proposals which demonstrate input from a wide-ranging consultative process and that meet the goals of economic growth and poverty reduction become MCA “Compacts” (CRS Report for Congress). Countries are responsible for implementation of their compacts. Once a compact is signed, each partner country must constitute an implementation entity that will be in charge of the implementation.

Regarding accountability, MCC’s focus on results in the three distinct phases of the project: pre-investment analyses; monitoring and assessment in implementation and post-implementation evaluation. Furthermore, MCC asks country governments during the compact proposal process to undertake public consultations and to make use of local institutions, both to talk about national development strategies and to gather the varied local perspectives and information needed to design sustainable programs (Phillips-Mandaville, 2009). This mechanism is important not only to avoid mismanagement of funds but also to develop civil society capabilities.

Eligibility criteria

The MCC eligibility criteria is a move form conditionality to selectivity and the use of public, objective criteria in making its selections, as opposed to a subjective or secretive selection process.

Two preliminary considerations are the country’s per capita GNI and whether or not that country is restricted from receiving US funds by congressional statute. Currently, the MCC recognizes two categories of country incomes: lower middle income – LMIC (with a per capita income between $3,255 and $1,575) and lower income – LIC (below $1,575). These two categories do not compete with one another on the good governance indicators (Dennis, 208). At least 75% of resources must be allocated to LICs. Originally funds could only be invested in LICs but that rule was relaxed in 2006 to broaden the number of potentially eligible countries by including some LMIC.

MCC only selects as compact-eligible those countries that have demonstrated government leadership and ownership of key policies related to good governance, social investment, and economic freedom. Candidate countries are ranked against their peers in the same income group on 17 independent policy indicators (MCC fact sheet). To be selected, a country needs to be above the median in relation to its peers on at least half of the indicators in each of the three policy categories. These indicators are developed by a third party outside of the U.S. Government, from various sources such as Freedom House, the World Bank, UNESCO, and Heritage Foundation,

The corruption indicator has a highlighted importance. Regardless of performance in other areas, a country is automatically disqualified if it fails the indicator measuring control of corruption- World Bank Institute's Control of Corruption index. As additional information, the Board may also consider how the country scores on Transparency International's Corruption Perceptions Index (MCC 2004). While many donors take corruption into account in making resource allocation decisions, MCC is currently the only donor that ties eligibility for assistance directly to performance on a publicly-available indicator of anti-corruption produced by a third party.

Since its implementation, the indicators for eligibility changed to some extent, to introduce more reliable and consistent data that became available to the MCC.

- At FY05, the MCC substituted the indicator for "Primary Education Completion" rates for a more specific indicator, "Girls' Primary Education Completion Rates".
- In FY06, the "Cost of Doing Business" replaced "Country Credit Rating" under the economic activity criterion.
- In FY08 the MCC combined "Days to Start a Business" and "Cost to Start a Business" into one indicator entitled "Business Start- Up", utilizing data and statistical information from the International Finance Corporation of the World Bank. Also, 2 other indicators were included, under the criteria of Economic Freedom "Land Rights and Access" and "Natural Resource Management" was included under the criteria of Investing in People.

Currently, for fiscal Year 2011, the Board uses seventeen indicators to assess the policy performance of individual countries. These indicators are grouped under the three policy categories listed below.

Ruling Justly	Encouraging Economic Freedom	Investing in People
Civil Liberties	Inflation	Public Expenditure on Health
Political Rights	Fiscal Policy	Public Expenditure on Primary Education
Voice and Accountability	Business Start-Up	Immunization Rates
Government Effectiveness	Trade Policy	Girls' Primary Education Completion
Rule of Law	Regulatory Quality	Natural Resource Management
Control of Corruption	Land Rights and Access	

Source: Millennium Challenge Corporation - Report on the Criteria and Methodology for determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance for Fiscal Year 2011

However, the Board of Directors still reserved the right to use discretion in interpreting and evaluating the information when making its final decisions. They are “empowered to take account of data gaps, lags, trends, or other material information, including leadership, related to economic growth and poverty reduction” (Radelet 2003). Even though this can bring subjectivity into the selection process, it is necessary measure given the weaknesses in the data.

For the most part, these indicators have been prudently selected, and they encourage policies that are actionable by recipient countries, quick to show results, are outcome-oriented rather than prescriptive, and are known to encourage economic growth (Sautet et al 2005).

Eligibility to receive MCA assistance, however, does not necessarily result in an aid grant. Countries must submit a proposal that will be reviewed by MCC board. MCC considers whether it is sustainable; will reduce poverty and generate significant economic rates of return; can be completed within five years; is consistent with other donor programs and the country’s national development strategy; and can be evaluated against agreed output and outcome benchmarks (Hewko 2010).

It is important to notice that Compact eligible countries that have not yet signed a Compact are expected to maintain Compact eligibility. For this reason MCC monitors the policy performance of eligible countries throughout the year to see if it continues its reform process and maintain and improve its overall policy performance on the indicators. A country remains eligible for MCC funds from the fiscal year in which it was chosen unless: Funds from that fiscal year are exhausted and The Board suspends the country from eligibility

Compacts

There are two primary types of MCC grants: compacts and threshold. Compacts are large, five-year grants for countries that pass MCC's eligibility criteria. They fund specific programs targeted at reducing poverty and stimulating economic growth. In 2010 Congress provided the MCC with the authority to enter into separate concurrent compacts and to extend five-year compacts to seven years (Tarnoff 2010). To date, MCC has signed 22 development assistance Compacts totaling over $8.2 billion.

Every Compact reflects its country's specific priorities and details program objectives, implementation methods, and monitoring and evaluation strategies, while ensuring financial accountability, transparency, and fair and open procurement processes. (MCC fact sheet)

After the country submits its compact program, proposal, MCC will take into consideration "whether it is sustainable; will reduce poverty and generate significant economic rates of return; can be completed within five years; is consistent with other donor programs and the country's national development strategy; and can be evaluated against agreed output and outcome benchmarks" (MCC fact sheet).

Thresholds

The Threshold Program, is intended to help candidate countries become eligible for an MCC Compact. Using the incentive of a potential MCC Compact, the Threshold Program is meant to encourage partner countries to design and undertake a challenging reform program (MCC, fact Sheet, 2010). Until the present MCC has funded twenty-three threshold programs worth over $495 million. The program is administered through USAID in cooperation with the MCC.

The MCC's threshold program grew out of a concern that too few countries would pass the eligibility selection criteria. To allay these fears, the MCC's legislation authorizes up to ten percent of total funds "to provide assistance to a candidate country... for the purpose of assisting such country to become an eligible country" (Staats 2010).

The program can also be a response to a shortcoming arising from the selection criteria for compacts, the fact that it may exclude the countries that are most in need of MCC aid. This would happen in the case potential recipients are willing to obtain a grant focusing on the very deficiencies that make then fail to classify. Even if there is political will, it is difficult for an impoverished nation to raise health or education standards (and particular corruption) to a level high enough to meet the eligibility criteria when there are no funds available to do so. For this reason, the threshold Program, intended to support countries which have shown a commitment to improvement but are still struggling to begin the reform process, is a welcome initiative within the aid industry.

Like Compacts, funding is not guaranteed for each country selected for the Threshold Program, but will be based on the quality of the Country Plan. In order to qualify for assistance, countries must submit concept papers identifying: (i) where and why the country failed to pass specific indicators; (ii) proposals for reforms that would improve these indicators; and (iii) types of assistance, required to implement these reforms (CRS Report for Congress, 2007).

Since control of corruption is the only “hard” indicator that must be satisfied in other to classify for compacts, 54 percent of threshold budget is directed towards this indicator, So far, all but four threshold programs (Burkina Faso, Guyana, Jordan, and Sao Tome and Principe) focused on the control of corruption. The table on the Appendix show all threshold countries that received funding to control corruption, the other indicators below the mean at the time of threshold eligibility, the reforms the threshold program targets and trend of 2 corruption indicators, WBI, and the CPI. Two countries, Paraguay and Albania already signed second threshold programs, both to continue to battle corruption.

The fact that countries are receiving a program extension is an important step forward in the MCC framework since it has been variously argued that two years is insufficient time to alter the indicators. For the same reason, 2 of the threshold contracts signed in 2010 had a 3 years period (Timor Leste and Liberia). Table II in the appendix provides a summary of the Paraguayan Threshold program to illustrate the threshold mechanism.

MCC Effect

The term “MCC effect” is being used to describe improvements in policy performance in countries that are either seeking to become eligible for MCC assistance, or have already been selected as eligible and are continuing the reform process. The reasoning is that the reform- mindedness of recipient countries will generally increase once aid is disbursed according to the relative performance of competing countries.

The possibility of MCC funding could create an incentive for developing countries to improve their political and economic institutions even before the MCC allocated any development assistance. It can be argued that the MCC compacts can even have a less important impact on growth then the policy changes that countries undertake to qualify for the MCC assistance.

Former MCC CEO John J. Danilovich, stated in a speech " The incentive of becoming MCC eligible has prompted many countries to re-evaluate their policies, regulations, and legislation related to good governance, health and education, and their business climate… this is a welcome result of something I call the MCC effect (MCC press release 2006).

Do date, 2 empirical studies control for the existence of an incentive effect. In a 2006 working paper, Harvard economists Doug Johnson and Tristan Zajonc check empirically for an effect early in the MCC's existence. Examining the rate of reform of governance indicators both before the advent of the MCC and after its creation, from a sample of 102 possible recipients, they find that the MCC incentive effect is real as indicated by the change in behavior of potential recipient governments. They concluded saying "we find substantial evidence that countries respond to MCC incentives by improving their indicators. Controlling for general time trends, potential recipients of MCC funds improve 25 percent more indicators after the MCC was created than before it."

A more recent study, from Öhler, Nunnenkamp and Dreher (2010) focusing specifically in the control of corruption finds that the MCC was successful in promoting better control of corruption. Their conclusion is that "Candidate countries that had reasonably good chances of gaining access to the MCC […] fought corruption more effectively than other candidate countries. "

Anecdotal evidence of such a trend is found in the Literature and in MCC reports. In Armenia, presidential contender Vartan Oksanjan referred to MCA funds when calling for increased openness in the upcoming election stating, "We are now in a situation where any step away from democratization and a repeat of electoral fraud will have an economic cost. And I can name that cost: 235 million dollars." MCC 2005 report to congress claimed that 80 percent of the reform on the "days to start a business" indicator for candidate countries can be attributed to the MCA. The claim arose from the WB "Doing Business" report, which asked countries directly for the reasons they reformed the indicators (Johnson and Tristan 2006).

In 2007 Bangladesh, a country that was neither compact eligible nor chosen for a threshold program, submitted a detailed action plan to MCC designed to help improve its scores on a number of MCC indicators (Hewko).

Another important effect of the MCC is that it is becoming a seal of approval for private investors as envisaged by Collier (see discussion on selectivity above). MCC encourages compact-eligible countries and their Millennium Challenge Account entities (MCA) ways to engage the private sector for leveraging and helping to ensure sustainability of investments made by the Compact (MCC, Private Sector initiative Toolkit). El Salvador serves as an illustration. FOMILENIO, the Salvadoran MCA entity, recently signed a $33 million public-private partnership agreement with AES Corporation to connect approximately 30,000 rural households to the electric grid.

How is MCC addressing corruption?

MCC is addressing corruption in three ways: (i) the selection process is a powerful incentive for countries to adopt tough anticorruption reforms (ii) using threshold program to scale up and accelerate the anticorruption programs of reform-minded governments and (iii) by advancing the global anticorruption agenda by institutionalizing the idea that foreign aid should be a two-way street. If donors are going to provide more assistance, recipient countries need to provide greater accountability and deliver results (MCC - working paper on corruption).

MCC works with the principle that successful anticorruption programs must be tailored to local institutions, knowledge, culture, social structures, and technologies. Every country's history of governance is different and each policy intervention needs to be tailored to these context-specificities. This is a response from critics of multilaterals institutions anticorruption policies that are design as a "one size fits all model".

All threshold countries must provide a detailed diagnostic of their performance on the WBI Control of Corruption index. In some cases, these diagnostics reveal that the judiciary is the key obstacle to lasting anticorruption reform; in other cases, illicit behavior appears to be concentrated in customs administration, public procurement, or business licensing. Countries will then tailor its anti-corruption strategy in accordance.

Here, it is important to highlight an important shift in US policy towards corruption. Historically the majority of USAID experience in fighting corruption has focused on administrative corruption due the risks of inadvertently supporting political vendettas. However, in 2005 USAID announced its intention of focusing in grand corruption as well. Since countries are expected to take the lead in designing programs, both grand and administrative corruption will be covered in the threshold agreements. This experience will provide a unique opportunity to compare and contrast a large body of anticorruption activity (USAID 2009).

Besides, using WBI Control of Corruption indicator as "passing score" MCC believes that it is identifying and supporting reform champions, even in countries where policy performance is not particularly high in absolute terms. (MCC working paper on corruption)

Critiques

In this part, the paper will draw attention to some of the main criticisms that MCC received by academia and practitioners. It will try to refute some of the critics and make recommendations for the pertinent ones.

- **Selectivity** may provide incentives to improve policies prior to receiving aid, but recipients would still have the option to reverse reforms after having been selected by donors. (Ohler et al 2010)

Countries that backslide on governance can be removed from eligibility, or have MCC agreements cancelled or suspended if scores decline due to policy reversals. During the past year MCC has backed up theory with action: it has withheld, suspended, or terminated assistance to Nicaragua, Armenia, Honduras, Madagascar, Niger and The Gambia for failing to adhere to the MCC eligibility criteria. (Hewko 2008). The credible threat of punishment is necessary to ensure the MCC's ability to enforce compliance in future clients.

The Gambia for instance was suspended in June of 2006 after being deemed "compact eligible" in 2005; the suspension was due to deterioration in human rights, political freedom and corruption. In 2009, the MCC Board warned Niger that it appeared to be moving away from its reform agenda, and further suspended the program due to undemocratic actions taken by its leadership contrary to the MCC's governance criteria (Tarnoff 2010).

- **Speed of spending** and implementation is also a recurrent disapproval of the MCC, especially in Congress, reflected largely by the limited amount of disbursements made to date (Tarnoff 2010).

Because the MCC is not required to disburse appropriated funds annually, there is less pressure to agree to questionable projects. The MCC evaluates country proposals and offers advice or requests additional information necessary to meet legislative requirements (Schaefer, 2005). Only when both parties reach an agreement funds are disbursed. This should be seen as an advanced of MCC structure and not as a concern. Besides, most compacts are investments in infrastructure and this takes time, especially if they ensure quality and incorporate proper oversight (crucial to avoid corruption as well). Also, funds are not channeled through existing structures but trough newly implemented agencies and in many countries the first year of MCA programs is spent investing in these agencies capacity to strengthen planning, financial management, reporting, and monitoring.

- There is a concern that the move to selectivity is **neglecting the most needed countries**. The argument is that the poor world is divided into “aid orphans”, bereft of any patron, and “aid darlings”, doted on by competing agencies (The Economist 2005), and that MCC could make this polarization even worst.

As President Bush made clear in his speech, MCC is *additional* fund. The MCC is just one agency among the whole foreign aid structure of the United States. USAID is still providing money for humanitarian emergencies or allocating funds in accordance to political interests of the U.S. and this is a legitimate claim. Besides, the Threshold Program is design to help the “aid orphans” that demonstrate commitment to reform. So the division is more about countries with commitment to reform and countries without commitment and not on developmental needs.

The same rationale works for other multilateral and bilateral agencies. For instance, several bilateral Donors provide funds for some countries through Budget Support and opt to use other form of disbursement at countries with weak governance.

DFID, in a recent White Paper explaining its approach to selectivity argues that “If a partner government is not committed to […] partnership commitments, we do not use conditions to try to impose these commitments. Instead, we may choose to support poverty reduction by working with partners other than government and in ways that seek to build the government’s commitment” (DFID 2009).

- **Indicators / eligibility criteria** is the most common concern. Several weakness of governance measurements are pointed out (Nakagawa 2005, Rieffel, and Fox 2008, Kaufmann 2002).

Defining the eligibility criteria is a critical issue since there is considerable debate about just what policy and institutional conditions are necessary for aid to be effective and therefore what shoud be included at the eligibility requirements. (Radelet 2005). MCC’s choice of indicators seems to have being received with small criticism. However, even presuming an agreement with the indicators, errors in measurement can lead to inaccurate evaluations and this fact has being highly criticized.

As discussed, governance indicators have **substantial margins of error** meaning that for the majority of countries there is a non-trivial probability that they could be mistakenly classified in the bottom half of the sample when a more accurate measurement would have indicated that they should be in the top half, and vice versa. (Kaufmann and Kray 2002).

Another problem critical to MCC is the **time lag** between the indicator assessment and the actual level of governance. For indicators with a long lag, current conditions in the country may differ significantly from those measured by the objective indicators and lead to a miscalculation of eligibility.

Some of the organizations from which ratings are collected have reduced the gap between data collection and dissemination and are improving the margin of errors (adding more sources). Nevertheless, the criticism is valid and the discretionary of the Board of Directors – that is itself focus of criticism – can attenuate this problem.

The MCC board at the discretion to judge an indicator look at a number of factors, including the many underlying data sources that make up indicators, as well as recent steps taken by the government in question to address corruption (or, in some cases, recent increased allegations of corruption). (Tarnoff, 2010). But it is not clear how much additional information is used and this can be correctly argued as a setback of the eligibility criteria.

However, cross-country indicators, even with a smaller margin of error, can only put in the picture a superficial level of the trend in governance, measurement will always be imprecise and therefore further complementary efforts are required. Corruption as argued in the session of governance indicators, is mostly hard to measure, with large margins of error particularly when relying on limited data sources, notwithstanding it is used as a "pass-or-fail" criterion.

To understand what kind of corruption affects a country, it necessary to include qualitative analysis. An In-depth diagnostic of countries that are just above or just below the mean would have the benefit to inform policy- makers the gaps and priorities to formulate actions and reforms.

In fact, through the Threshold Programs MCC achieve exactly this result by focusing on intermediate countries, or countries which indicators are just below the mean, MCC is able to work with a country for 2 or 3 years and have a hands on approach to commitment to reforms in the country. Countries willing to engage in the Programs must do a self-diagnostics and provide the pathway to implement reforms. This internal assessment is a better source of information to the Board and together with the speed of implementation of reforms can be used as future source for judgment on the eligibility capacity for a Compact.

The problem therefore remains in the assessment of countries that do not receive a threshold contract. Leading to the conclusion that MCC must consider having some kind of qualitative date to its analysis, not only to control for eligibility but also to control the change in its Threshold Programs. This will also help to bring the topic of corruption in the international community agenda.

- The final critique is that MCC is helping **Threshold countries** meet the eligibility criteria, and therefore undermining the MCC principle that countries themselves should be responsible for achieving the eligibility criteria and makes the MCC partially responsible for indicator performance (Herrling et al 2009, Radelet 2005).

MCC supports countries that show enough political will to implement reforms but that may be lacking funds or technical skills. Countries must be willing to carry out its own self-diagnostic utilizing a rigorous framework, as well as embracing transparency and participation in its process. Countries deemed eligible for the program had to submit concept papers identifying where and why the country failed to pass specific indicators; make proposals for policy, regulatory, or institutional reforms that would improve the country's performance on these indicators; and note types of assistance, over a two-year maximum period, required to implement these reforms (Tarnoff 2010). This is in accordance to MCC's ownership principle. This internal evaluation and program implementation will provide good governance reforms and thereby help the country to move up the ladder of the indicator on their own.

Final Considerations - Unrealistic Expectations and Assumptions

To measure whether or not MCC is a successful program it is first necessary to make clear the terms from which success will be measured. This paper proposes a more narrow approach to the judgment there has being made by US congress.

To illustrate the point of this "high expectation" an extract of a Hearing in the US Congress to analyze the Vanuatu Compact is cited here (US Congress 2007). "The Millennium Challenge Corporation has stated time and again that it is guided by the principle that transformative economic growth occurs and succeeds in reducing poverty when countries take full responsibility for their own development. Partnership and complete engagements are the ingredients for successful developing policies. This committee in the past has been supportive of these guiding principles; however, we have serious questions about the availability and the capability of the MCA to fulfill these goals" (Congressman Faleomavaega).

A "transformative economic growth" is an unrealistic expectation. As the discussion in this paper showed, there is no consensus among academia and policy makers that foreign aid improves growth. If there is no empirical evidence concerning all aid that has been provided in the world so far, to expect a single bilateral agency to be transformative is out of question.

As acknowledged by Lancaster (2008) "With the complexities of the multiple factors, alone or in combination, spurring growth, the MCC is more of an experiment in improving aid effectiveness than an exercise with predictable results, despite the fact that it has been presented to Congress and the public as the latter."

Besides, the following must be considered when evaluating the MCC:

- The notion that MCC could transform a country with one or more large compacts is not feasible.
- Funding, initially announced at $5billion per year was never met. This is a diminishing effect of incentives to promote good governance.
- The time lag for which the program is being judged is too short.
- Recipient countries by definition have constrained capacity.

The MCC model is based on the premise that countries are ready, willing and able to take ownership of the planning, implementation and monitoring of development strategies. But institutional capacity levels in the poorest countries are restricted. Meaningful public participation takes time, expertise, and resources (Lucas 2007). These assumptions created unrealistic expectations that the agency had to confront and manage.

Building institutions and better governance takes time and money. Compacts have a time limit of 5 years (Congress passed legislation to FY2011 permitting extension to seven years), too short a period to expect a big transformation in countries that need all kinds of institutional building. Besides, funding has been way below the expected. At the same hearing mentioned above, Congresswoman Diane Watson, linking the problem of lack of funding and high expectation declared "I would like to say clearly to them, you can't call for foreign assistance as a pillar of America's national security strategy and then fail to fund the resources to support it."

As best captured by Hewko (2008) "Even though MCC countries are performing relatively better than their peers, as evidenced through their performance on the MCC selection indicators, the program's limited resources and the sheer number and scope of development issues that need to be addressed should temper expectations as to the scale and scope of success to be expected from MCC compacts. To the extent that MCC aspires to be "transformational," that goal should be limited to sectors or regions rather than economies as a whole."

That said, it is argued here that two other questions should delimitate the analysis instead. First, are the MCC projects achieving the outputs they are intended to achieve? Second, is there an incentivizing effect, prompting governments to improve good governance (an most importantly curbing corruption)?

First, to measure projects outputs it is necessary to go on a case-by-case basis. So far, only a few compacts and threshold programs have terminated and MCC reported several cases of success but it is still too early to make a final statement in this regard.

Concerning the Threshold Program, 8 countries completed its programs so far (Albania, Burkina Faso, Jordan, Malawi, Paraguay, Philippines, Tanzania and Zambia). Between then only Jordan and Burkina Faso didn't have corruption as an objective. Paraguay and Albania already signed phase II Threshold programs to keep improving their control of corruption and the other 6 countries signed Compacts already. As the case of Paraguay illustrates (see Appendix) corruption is widespread in these countries and although indicators showed a slight improvement in some countries in recent years countries still have a long way to go. But this does not mean that there is no success, only that success was achieved in the small interventions that MCC made, in accordance to each countries implementation agreement. The US initiative must be recognized.

Concerning the incentivizing effect, as demonstrated above, MCC has an important effect in making countries improve their indicators, in putting important development issues at the agenda, changing national mindsets about development and raising the bar on transparency.

Regarding and effect in the corruption indicator this paper comes to a dead end. It is not possible to evaluate whether or not MCC has an impact in the Threshold countries because comparative composite indexes such as the CPI or the WGI are of very limited value to track change over time and measure impact of anti-corruption efforts. Only a more profound case study of each individual country would be able to make a final consideration in this regard.

This is not to say that the impact of MCC in putting corruption in the agenda is limited. On the contrary, peer pressure is an important part of anticorruption policies and indexes such as the CPI and WBI are important to expose corruption. Having an important political actor such as the US using these indexes to implement policy is already a success. Although the US must begin to disburse more aid, in much larger amounts, to sustain any such effect.

Conclusion

This paper showed that even though the concept of good governance doesn't have an operational definition it is now part of the development community strategy to achieve more aid effectiveness. By shifting from a strict conditionality to a more selective approach donors are pushing for country led reforms. Each donor is experimenting a different mix of good governance indicators, all measured by an increasing number of indicators developed in recent years.

In the first part the paper introduced the debate about aid effectiveness and good governance to provide the basis for the understanding of the selectivity approach. It showed that the focus of foreign aid effectiveness debate shifted from the question "Does aid work?" to a more extensive one: "How can aid be more effective to alleviate poverty?"

Further it demonstrated how control of corruption is the most important component of the "box" of good governance policies used to implement a more selective foreign aid. It showed that in spite of the limitation relating the timely and accurate measurement of governance indicators in general and corruption in specific, allocation of aid can be linked to better policies in recipient countries and aid should be only given to countries that are able to demonstrate a commitment to curb corruption.

The final section introduced the Millennium Challenge Corporation, an innovative and independent U.S. foreign aid agency that uses governance indicators to reward good performance countries. The MCC breaks with practice on foreign aid in important dimensions. It introduced concepts of ownership and accountability and helped to put good governance in the agenda.

Internal ownership of reforms is key to an effective policy implementation because it provides the political support necessary for improvement in any governance dimension but it is particularly important to implement an anti-corruption strategy. Any kind of institutional reform is hard to do because it violates the interests of powerful groups, and usually have no active political constituency. With corruption, the bottom line is that they are tough to implement precisely because they are the least politically supported. Even those that are "owned" by reform-minded leaders or have been discussed with civil society groups will not necessarily get implemented.

MCC also takes country selectivity much further than previous programs by using public and independent indicators produced by third parties. Most of the indicators are universal goals and not only economic indicators. Regardless of the precise impact MCC will have in long-term growth the fact that it is helping countries to improve their indicators themselves and putting corruption as a priority among the conditions to receive foreign aid makes it already successful. Poor governance as demonstrated here, is the biggest impediment to development. By increasing governance indicators countries will be at the same time improving its institutions and as a consequence lowering opportunities to corruption.

Finally this paper make a case for a more comprehensive assessment methodology in order to judge the real impact of MCC policies to fight corruption. This is because assessing corruption trends and impact of anti- corruption measures on actual levels of corruption continues to face major methodological, political and operational challenges in spite of increased empirical research on corruption and all the new datasets. For this reason, quantitative indicators should not be the only measure to access corruption and progress should be measured trough a more detailed qualitative analyses as well.

Comparative composite indexes such as the CPI or the WGI are important to give a bigger picture of the amount of corruption in a country and they also play an important role in raising awareness on corruption, however they are not able to capture the several dimensions of corruption, are of limited value to track change over time and to measure short term impact of anti-corruption efforts. Usually the impact of reforms is only perceptible within a higher time lag and will not therefore be indicated in the following year grade.

Since there is no single valid and reliable indicator of progress in the fight against corruption, the alternative approach would be to use a range of indicators, data sources and methodologies - both qualitative and quantitative- to track progress and corruption trends over time. But so far that has not being done not even by the MCC that have the “control of corruption” indicator as a pass or fail mechanism. Rampant corruption is a symptom of widespread institutional failure throughout the country and only a qualitative analysis can access the dimensions corruption takes in a given country.

Donors must support politically committed leaders and help to create a system of effective and transparent institutions. Programs like MCC, if fully transparent and with sufficient leverage would catalyze internal changes needed to only to curb corruption but to bring greater development.

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Annex

Figure 1 – Margins of Error and Governance Rankings

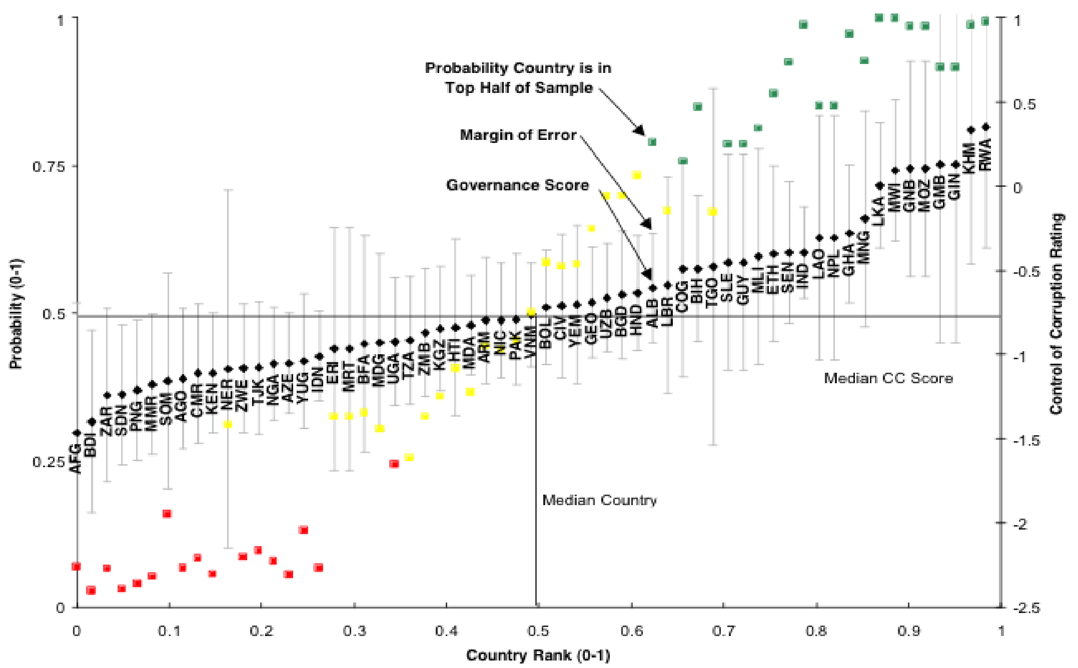

Table 1: Paraguay Threshold Program

In 2006 the United States and Paraguay signed the first Threshold Agreements, that was concluded in August 2009, The program has been credited with reducing the time it takes to start a business by half, among other accomplishments. In 2009, a Stage II Program was signed. The program builds on Paraguay's first Threshold Program, and focuses on anti-corruption efforts in law enforcement, customs, and the healthcare and judicial sectors.

The agreement focuses on 2 aspects of corruption: impunity (implement an effective sanctioning system) and informality (reduce informal economic activity). The Agreement is then divided into 10 components 5 for each of the 2 aspects, with policies to be address in each category. **Impunity** – Focusing on strengthening (i) the Public Ministry, (ii) the judiciary disciplinary system, (iii) the public registry, (iv) the Controller Generals Office (trough civil society control) and (v) public finance. **Informality** – Focusing on strengthening (i) the Tax Authority, (ii) border and customs control and (iii) Ministry of Finance investigative capacities. (i) Create one-stop agencies to register new business and (v) improve the *Maquillas* system (exporter companies with tax benefits) .

In 2008 Fernando Lugo, a former Roman Catholic bishop, was elected under a strong anticorruption campaign ending 61 years of one-party rule by the still-dominant Colorado Party. Lugo. But his party, the Patriotic Alliance for Change (APC), does not have a majority in either house of the Paraguayan Congress, and the Colorado Party, which still has a strong presence in Congress, has threatened to block his reforms. This political shift can be observed in the evolution of the indicators that demonstrated a small decline, after some years of improvement. It is difficult to assess whether there was real decline in the control of corruption or if the perception based indicators are only capturing the political transition going on at Paraguay at the moment.

Sources: www.mcc.gov / Beitte, S.(2010) Paraguay: Political and Economic Conditions and U.S. Relations / BBC Country profiles

Figure 2: Country Score Card for Fiscal Year 2009 (Initial year of Threshold Program Phase II)

How to Read this Scorecard: Each MCC Candidate Country receives an annual scorecard assessing its performance in 3 policy categories: Ruling Justly, Investing in People, and Economic Freedom. Under the name of each indicator is the country's score and percentile ranking in its income peer group (0% is worst; 50% is the median; 100% is best). Under each country's percentile ranking is the peer group median. Country performance is evaluated relative to the peer group median. Scores above the median, represented with green, meet the performance standard. Scores at or below the median, represented with red, do not meet the performance standard. The black line that runs along the horizontal axis represents the peer group median. Each World Bank Institute indicator is accompanied by a margin of error, which is represented by the vertical blue bar.

For more information regarding the Millennium Challenge Account Selection Process and these indicators, please consult MCC's website: www.mcc.gov

Table 2: Summary of Threshold Programs and evolution of Corruption indicators

Country	Date Threshold program Grant Signed	Grant Total (in millions)	Indicators below the Median (when deemed eligible for threshold status)	Threshold Program Focus	WGI 2009 2004	TI 2010
Albania	April 3, 2006	13.85	Control of corruption Rule of law Primary education expenditures Credit rating Days to start a business Trade policy Fiscal policy	Control of corruption (tax administration reform, public procurement reform, business registration reform)	-0.40 -0.46 -0.60 -0.72 -0.72 -0.76	3.3 3.2 3.4 2.9 2.6 2.4 2.5
Albania II	September 29, 2008	15.7	Control of corruption Government Effectiveness Rule of law Health Expenditures Girls Primary Education Completion Natural Resource management Fiscal Policy	Control of corruption (improving rule of law in administrative court proceedings, tax administration reform, business registration reform building and construction permitting reform, Support of Civil Society)	-0.40 -0.46 -0.60 -0.72 -0.72 -0.76	3.3 3.2 3.4 2.9 2.6 2.4 2.5
Indonesia	November 17, 2006	55.00	Control of corruption Immunization rate Health Expenditure Primary education expenditures Cost to start a business Days to start a business	Control of corruption (judiciary reform, strengthening capacity of accountability centers, implement electronic government procurement); Immunization rates	-0.71 -0.61 -0.60 -0.75 -0.86 -0.90	2.8 2.8 2.6 2.3 2.4 2.2 2.0
Kenya	March 23, 2007	12.70	Control of corruption Government effectiveness Rule of law Voice and accountability Health expenditure Primary education expenditure Days to start a business Trade policy Fiscal policy	Control of corruption (procurement reform, health care reform, enhancing procurement m&e)	-1.11 -1.01 -0.92 -0.88 -1.02 -0.87	2.1 2.1 2.1 2.2 2.1 2.1 1.9
Kyrgyz Republic	March 14, 2008	16.00	Political rights Civil liberties Control of corruption Government effectiveness Rule of law Voice and accountability Fiscal policy	Rule of law; Control of corruption (judicial reform, law enforcement reform, criminal justice reform)	-1.22 -1.07 -1.19 -1.21 -1.18 -1.01	2.0 1.8 2.1 2.2 2.3 2.2 2.1
Malawi	September 23, 2005	20.92	Control of corruption Girls' primary education completion Credit rating Fiscal policy	Control of corruption (corruption case processing, public procurement reform, audit capacity-building, media strengthening)	-0.47 -0.54 -0.70 -0.64 -0.79 -0.69	3.4 3.3 2.8 2.7 2.7 2.8 2.8
Moldova	December 15, 2006	24.70	Control of corruption Primary education expenditures	Control of corruption (judiciary reform, health care system reform, tax reform, customs reform, police agency reform, NGO anti-corruption monitoring)	-0.74 -0.61 -0.59 -0.63 -0.68 -1.00	2.9 3.3 2.9 2.8 3.2 2.9 2.3
Niger	January 30, 2008	23.00	Control of corruption Immunization rates Health expenditures Girls' primary education	Control of corruption (strengthening the legal framework, improving public procurement	-0.66 -0.80	2.6 2.8

			completion Natural resource management Business Start-Up Trade policy	systems and supporting the anticorruption efforts of civil society and the media) Starting a business Land rights and access Girls' primary education	-0.84 -0.92 -0.71 -0.91	2.6 2.3 2.4 2.2 (started in 2005)
Paraguay	May 8, 2006	34.65	Control of corruption Government effectiveness Rule of law Health expenditures Primary education expenditures Days to start a business	Control of corruption (enforcement of anticorruption regulations, formalization of economic activities)	-0.88 -1.00 -1.25 -1.31 -1.51 -1.45	2.2 2.4 2.4 2.6. 2.1 1.9 1.6
Paraguay II	April 13, 2009	30.30	Control of corruption Government effectiveness Rule of law Immunization rates Business Start-Up	Control of corruption Rule of law	-0.88 -1.00 -1.25 -1.31 -1.51 -1.45	2.2 2.4 2.4 2.6. 2.1 1.9 1.6
Peru	November 30, 2007	35.60	Government effectiveness Rule of law Health expenditures Primary education expenditures Natural resource management Business start-up Trade policy 3	Control of corruption (improving administrative systems and procedures, strengthening enforcement and increasing public awareness) Immunization rates (improving administrative and supply chain systems at the Ministry of Health)	-0.36 -0.22 -0.30 -0.26 -0.41 -0.33	3.5 3.7 3.6. 3.5 3.3 3.5 3.5
Philippines	June 26, 2006	21.00	Health expenditures Days to start a business Fiscal policy	Control of corruption (tax and customs administration reform)	-0.71 -0.67 -0.66 -0.72 -0.55 -0.53	2.4 2.3 2.5 2.5 2.5 2.6 2.5
Tanzania	May 3, 2006	11.15	Control of corruption Political rights Primary education completion Trade policy	Control of corruption (civil society monitoring, rule of law for good governance, Financial Intelligence Unit, public procurement reform)	-0.42 -0.41 -0.37 -0.28 -0.72 -0.61	2.7 3.0 3.2 2.9 2.9 2.8 2.5
Timor-Leste	May 28, 2010 (3 years)	10.5	Control of corruption Government effectiveness Rule of law Immunization rates Girls' primary education completion Primary education expenditures Natural resource management Regulatory Quality Lands Rights and access Business Start-Up Trade Policy	Control of corruption Immunization rate	-0.99 -0.90 -0.95 -0.89 -0.76 -0.55	2.5 2.2 2.6 2.6
Uganda	March 29, 2007	10.40	Political rights Civil liberties Control of corruption Rule of Law Voice and accountability Immunization rate Health expenditures Fiscal policy	Control of corruption (public procurement reform, improvement of audit and financial management practices, strengthening of civil society, capacity building to follow up on reported corruption allegations)	-0.87 -0.82 -0.80 -0.75 -0.86 -0.71	2.5 2.6 2.8 2.7 2.5 2.6 2.2
Ukraine	December 4, 2006	45.00	Control of corruption Girls' primary education completion	Control of corruption (civil society monitoring, judicial reform,	-0.90 -0.73	2.4

			Primary education expenditures	enforcement of anticorruption regulations, higher education)	-0.71 -0.62 -0.65 -0.89	2.5 2.7 2.8 2.6 2.2 2.3
Zambia	May 22, 2006	22.74	Control of corruption Government effectiveness Primary education expenditures Girls' primary education completion Credit rating Trade policy Inflation Fiscal policy	Control of corruption (property registration streamlining, border/trade management)	-0.51 -0.45 -0.52 -0.72 -0.81 -0.86	3.0 3.0 2.8 2.6 2.6 2.6 2.6