Will Politics Encroach in the MCA FY2007 Selection Round?
The Cases of Jordan and Indonesia

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The Board of Directors of the Millennium Challenge Corporation (MCC) will meet on November 8th to select the countries that will be eligible for FY 2007 funding. The Board faces many important decisions, as we describe in a companion paper *Round Four of the MCA: Which Countries Are Most Likely to Qualify in FY 2007?*. Perhaps the most controversial will be decisions about whether to select Indonesia and Jordan to be eligible this year. We think it is highly likely that the Board will select both countries, but we do not believe that either would be an appropriate choice.

Indonesia

Indonesia did not pass the indicators test in previous years, and it again does not pass for FY 2007, missing out in three separate ways. First, while it passes four of six "Ruling Justly" indicators, it does not pass control of corruption, falling just below the median. Second, it passes just one of four Investing in People indicators (the girls' primary school enrolment rate). Third, it falls "substantially below the median" (defined by the MCC as falling below the 25th percentile) on three indicators—public health expenditures (14th percentile), primary education expenditures (3rd percentile), and days to start a business (10th percentile). The MCC Board recently approved a $55 million Threshold Program for Indonesia focusing on two of the areas where it falls short—control of corruption and immunization—but the agreement has not yet been signed or implemented.

Despite these shortfalls in performance, we believe the Board is likely to select Indonesia, both because of a desire for the MCC to include more predominately Muslim countries, and because President Bush is scheduled to visit Indonesia in mid-November just after the Board meets.

At a broad level, Indonesia should be a very good candidate for MCA-type support. It has a long history of successful development, and has recorded among the fastest rates of economic growth and poverty reduction of any country in the world since 1970.[1] It is a new democracy, and is on the rebound after the effects of the Asian financial crisis, the fall of Suharto, and the 2004 tsunami. But these points all suggest that Indonesia should be fully capable of meeting the MCC standards without a special exception.

We are certainly supportive of the US providing strong support to Indonesia. ***But until Indonesia passes the indicators, the MCC is the wrong source to provide that support.*** The State Department or USAID are far more appropriate sources for the US to provide additional support. A Board decision to select Indonesia when it has not yet met the indicators standards while at the same time leaving out counties that have met the tests would threaten to undermine and politicize the MCC selection process and weaken the MCA "incentive effect," especially if the Board does not transparently explain its decisions.

Jordan

In contrast to Indonesia, Jordan passes the required number of indicators for the second year in a row (Jordan is assessed as a lower-middle income country or LMIC). It passes three indicators in each of the three broad MCC groups of indicators, and passes the corruption hurdle. However, it falls substantially below the median on the cost of starting a business indicator (9th percentile), so does not fully pass the indicators test. Last year the Board did not select Jordan as an eligible country, instead placing it in the Threshold category. In September, the MCC approved a $25 million Threshold program for Jordan which has not yet entered into force due to pre-conditional reforms.

We believe that the Board is likely to select Jordan this year, despite its falling "substantially below" the median on cost of starting a business, while at the same time not selecting other LMICs with stronger performance on the indicators (e.g., Brazil, Bulgaria, and Samoa). We think it will do so because Jordan is a strong political ally of the U.S., because the MCC would like to select more predominately Muslim countries, and perhaps so the State Department can reduce some of its other funding to Jordan and allocate the funds to other countries.

We strongly support the US policy of providing substantial foreign aid to Jordan, which is a long-standing and important ally. This is not a question about whether or not the US should provide support to Jordan. ***But the MCC is not the appropriate funding source***. US foreign policy goals should be met through State Department and USAID funding mechanisms, not the MCA, and the limited amount of MCA funding that is available for LMICs should go to countries that score better and have more limited alternative sources of funding. There are several reasons why selecting Jordan would not be the right choice for the MCC:

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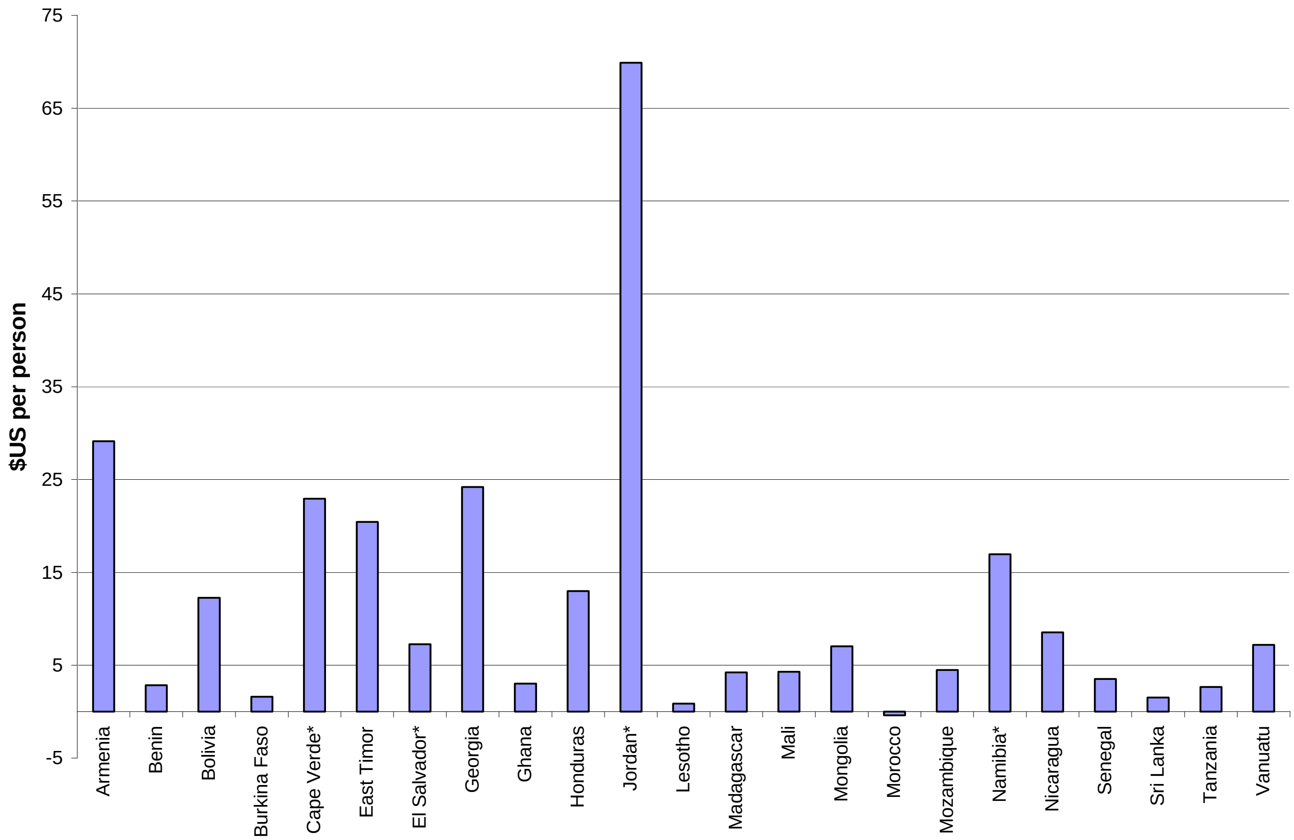
[1] It should be noted for full disclosure purposes that one of us (Radelet) lived in Indonesia for many years as an advisor to the government, so knows it well and if anything is biased to be very supportive had the case been stronger.

First, Jordan is already one of the largest recipients of US foreign aid. It was the 7th largest recipient of US official development assistance (as officially defined by the OECD) in 2005. Jordan received $380 million from the US in 2005 alone, more than 3½ times more than any other MCA-eligible country. The $380 million is equivalent to $70 per Jordanian, more than twice the amount that the US provided to any other MCA-eligible country, and seven times the MCA-eligible average, as shown in Figure 1.

Figure 1. US Official Development Assistance per capita, 2005 ($ per person)



Source: USG data submitted to the OECD for 2005.
* indicates lower-middle income countries

Second, Jordan has access to much larger private sector capital flows than most MCA countries. According to the World Bank, its gross private sector capital inflows amount to 18% of GDP in 2004, more than most (but not all) the other MCA-eligible countries. The MCC is all about providing new resources to poor, resource-constrained countries committed to strong development policies, and Jordan clearly has access to much larger financial resources than other MCA counties.

Third, Jordan is not a democracy. Although the MCC does not have a firm criterion to select only democracies, it has only selected one non-democracy in the past (Morocco). We believe that the MCC should be reserved only for democracies, with other US programs used to support non-democracies, where appropriate.

Fourth, a Board decision to select and ultimately provide MCC funding to Jordan is likely to result in the State Department reducing its current funding to Jordan and instead allocating it (or most of it) to a different ally, so on the margin the next US dollar would not be going to Jordan but to some other country, probably one with much weaker economic performance.

Fifth, and much more speculatively, if in the future Jordan performs poorly on a compact, the MCC will have great difficultly in adhering to performance-based standards and cutting off the grant for non-performance. If Jordan does eventually receive a compact it may perform very well, but in the event it does not we think the MCC would have a difficult time fully enforcing strong performance standards.

We fully support the US providing significant financial support to Jordan. But it should continue to do so through traditional channels, and not through the MCC. Selecting Jordan would appear to add a political element to MCC decisions, since Jordan clearly needs the funding much less than other countries, and would be chosen above other LMICs that score better on the indicators (e.g., Bulgaria, Brazil, and Samoa). It will be very hard for the Board to defend selecting Jordan while not selecting other countries, especially given its access to other resources, without it appearing that political considerations were a deciding factor.