REGIONAL ECONOMIES

THE COMMONWEALTH OF INDEPENDENT STATES ON THE MILLENNIUM CHALLENGE ACCOUNT SELECTION INDICATORS: GOVERNANCE IS THE MAIN CHALLENGE

Maks KOBONBAEV

*A consultant at the World Bank in Washington D.C.;
is pursuing his doctoral degree in political science & policy and
holds master's degree in public policy administration
from the University of Missouri
(St. Louis, U.S.)*

Promise of the Millennium Challenge Account

In March 2002, in Monterrey, Mexico, President Bush announced the creation of a bilateral development fund, the MCA, as the U.S. contribution to the United Nations Conference on Financing for Development. According to the plan, Bush pledged US$1.7 billion for FY 2004, US$3.3 billion for FY 2005 and US$5 billion for FY 2006, representing a 50 percent increase in the amount of aid focused strictly on development assistance.[1] This marshaled the largest U.S. foreign aid increase in decades. Steve Radelet wrote in *Foreign Affairs*, "This move was one of the greatest surprises of George W. Bush's presidency so far."[2] Indeed, the MCA could bring about the most fundamental changes to U.S. foreign assistance policy since the Kennedy administration.[3]

The author would like to acknowledge valuable comments provided by Professor Andrew Glassberg.

[1] See: B. Schaeffer, "The Millennium Challenge Account: An Opportunity to Advance Development in Poor Nations," *Heritage Lectures,* No. 753, 27 June, 2002.

[2] S. Radelet, "Bush and Foreign Policy," *Foreign Affairs*, Vol. 82, No. 5, 23 September, 2003, pp. 104-117.

[3] See: A. Natsios, "Challenging Orthodoxy: Changing Perspectives on Development." The Remarks by Andrew Natsios at the U.S. Agency for International Development, 21 October, 2002.

Historically, the bulk of U.S. foreign assistance did not have economic development as its primary purpose. Instead, it was based on foreign policy goals. Brainard *et al*. note that though development assistance was originally intended to address development needs, decisions on aid allocation were based on foreign policy priorities.[4] In other words, aid was given primarily to strategic partners though it depended on recipient countries whether they used aid for their growth. During the Cold War, foreign aid was mainly allocated to contain communism. For example, Taiwan, South Korea, Turkey, Vietnam, and others have received aid from the U.S. on this principle. In addition to the containment of communism, the aid was allocated to advance U.S. foreign policy in hydrocarbon abundant Middle East. As a part of the Camp David accords, Washington also provided a large share of ESF[5] to Egypt and Israel, which are considered the largest aid recipients up to this day.[6]

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

After 11 September, foreign aid gained attention again. The Bush administration pledged US$297 million to Afghanistan, US$600 million to Pakistan and US$250 million to Jordan to fight terrorism and promote democracy.[8] But the main surprise was the initiation of the MCA. In view of the increases in foreign assistance to post-war Iraq, Afghanistan and Pakistan to fight terrorism and to Africa to fight AIDS, the Congress could not commit itself to President's original generous pledge to initiate the MCA program. But it has still gone from vision to operation. The Millennium Challenge Corporation (MCC) was established on January 23, 2004. The Congress managed to appropriate US$1 billion in FY 2004 and US$2.3 in FY 2005 to organize and pilot the MCA program. The President seeks US$3 billion for FY 2006, more than the FY 2005 level, but less than the original US$5 billion commitment for the third year.[9] Even if the real funding is lower than the originally pledged in Monterrey, it still represents one of the drastic increases in foreign assistance in a half a century, outpaced only by the Marshall Plan and the Latin America focused Alliance for Progress in the early 1960s.[10]

Other than marking a dramatic increase in bilateral aid, the MCA is also a drastically different aid allocation strategy. First, the MCA has a clearly defined objective to promote development. Second, the MCA emphasizes country ownership in development, recognizing that a country's own commitment, initiatives, policies and institutions play a substantial part in its development outcomes. Third, it is intended to allocate aid based on results. Finally, a relatively small number of recipient countries are selected based on their demonstrated commitment to development.[11] The MCC uses a set of *objective criteria of selection* to determine MCA eligibility.

---

[4] See: L. Brainard, C. Graham, N. Purvis, S. Radelet, C. Smith, *The Other War: Global Poverty and the Millennium Challenge Account,* Center for Global Development and the Brookings Institution Press, 2003.

[5] Washington's aid accounting makes a key distinction between developmental assistance and geopolitical aid, which is distributed to strategic countries mostly as economic support funds (ESF).

[6] See: S. Radelet, op. cit.; L. Brainard, C. Graham, N. Purvis, S. Radelet, C. Smith, op. cit.

[7] See: S. Radelet, "Will the Millennium Challenge Account Be Different?" *The Washington Quarterly,* Vol. 26, No. 2, 2003, pp. 171-187.

[8] See: S. Radelet, "Bush and Foreign Policy," p. 108.

[9] See: L. Nowels, "Millennium Challenge Account: Implementation of a New U.S. Foreign Aid Initiative," CRS Report for Congress, Updated 1 July, 2005.

[10] See: S. Radelet, *Challenging Foreign Aid: A Policymaker's Guide to the Millennium Challenge Account,* Center for Global Development, 1 May, 2003; L. Brainard, C. Graham, N. Purvis, S. Radelet, C. Smith, op. cit.; L. Nowels, op. cit.

[11] See: Sh. Herrling, S. Radelet, "The Millennium Challenge Account: Soft Power or Collateral Damage," *Center for Global Development Brief*, Vol. 2, No. 2, April 2003.

The MCA Selection Indicators and Process

The MCA selection strategy is based on the *need* by countries for the funds and their *performance*. The need criterion is measured by income per capita set by the MCC. The performance criterion is measured by 16 selection indicators under the broad categories of "ruling justly," "investing in people" and "economic freedom" (see Table 1). To pass the performance criterion, countries must perform above the median in relation to their peer MCA candidate countries on at least half of the indicators on each of the three policy categories of "ruling justly," "investing in people" and "economic freedom" and score above the median on the corruption indicator. The only exception to the median approach is that for the inflation indicator a fixed ceiling of 15 percent and for civil liberties a fixed score of five are used. In addition to these objective criteria for selection, the MCC can exercise discretion in evaluating the indicators into a final list of eligible countries. Upon necessity, the MCC can also consider other quantitative and qualitative information to determine if a country deems eligible. The MCA appears to be the first program that employs pre-announced quantitative indicators to select recipient countries.[12] The indicator test builds on the idea that aid is most effective in countries with governments that are implementing sound development policies.

MCA Selection Process: The MCC Board of Directors determined 16 eligible countries for MCA funding in FY 2004.[13] On November 8, 2004, the MCC made its selection of FY 2005 eligible countries. The number and composition of FY 2005 eligible countries remained the same as in FY 2004 except that the Board chose one new country (Morocco) and Cape Verde was not selected because its per capita income exceeded the minimum requirement.[14] In FY 2004, the Board selected

Table 1

The MCA Selection Indicators

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

Source: The MCA Report on the Criteria and Methodology in FY 2005 and FY 2006

[12] See: S. Radelet, "Bush and Foreign Policy," pp. 104-117.

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

[14] See: L. Nowels, "Millennium Challenge Account: Implementation of a New U.S. Foreign Aid Initiative," CRS Report for Congress, Updated 1 July, 2005: CRS-8.

ten countries on the basis of the predetermined objective criteria and used some discretion for other six countries.[15]

The number of MCA candidate countries has increased in FY 2006 because, regardless of wide criticism from academic and development community, the MCC has added the "lower middle income category" (LMIC) countries to compete for the MCA funds. For FY 2006, the MCC has selected 23 eligible countries. 20 countries are from the "low income category" (LIC)[16] and three are from the LMIC. 16 have been MCA eligible in FY 2005. Burkina Faso, East Timor, Gambia and Tanzania become MCA eligible for the first time in FY 2006 from the LIC. The selected LMIC countries are Cape Verde, El Salvador and Namibia.[17]

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

Ranking of the CIS Countries in FY 2005: There are six in FY 2004, eight in FY 2005 and ten in FY 2006 MCA candidate countries from the CIS region (see Table 2). In FY 2004 and FY 2005, Belarus, Kazakhstan and Russia were not MCA candidates because they had higher income than the minimum requirement. Uzbekistan has been the only CIS country prohibited from receiving U.S. economic assistance under Part I of the Foreign Assistance Act of 1961. From the pool of CIS countries, the MCC has selected Armenia and Georgia as MCA eligible. While the selection of Armenia was based on its ranking on the objective indicators, the selection of Georgia was subject to controversy. Lucas and Radelet report that, in FY 2004, Georgia did not do well on "ruling justly," "investing in people" and "economic freedom" indicators.[18] Georgia also did not pass the control of corruption hurdle.

The MCC declared that it would select countries based on their performance and need for the MCA funds. In FY 2005, based on the overall differences between passed versus failed indicators, Georgia performed worse than Armenia, Moldova, and Ukraine and its corruption score was lower than in Armenia, Kyrgyzstan, Moldova and Ukraine (see Table 3). Obviously, if performance had been the main criterion for selecting Georgia, then Ukraine and Moldova would have been more qualified. If the need[19] had been the main criterion for selecting Georgia, then Moldova with two times less per capita income than Georgia would have been better qualified. It is obviously not clear why Georgia was selected instead of, for example, Moldova, which had higher need and better performance than Georgia.

One of the main arguments used to defend Georgia's selection is that it has established anticorruption agencies and pursued governance reforms (e.g., procurement transparency and unified treasury accounts) and declared its full commitment to democracy. However, Radelet comments, "[the selection of Georgia] ran directly counter to the core idea of the MCA that countries are chosen on the basis of demonstrated commitment to strong development policies, not on promises."[20] He rightly criticizes that this is a weak rationale because many countries have declared their fight against corrup-

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

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

[17] See: MCC Press Release, "Millennium Challenge Corporation Board Names Fiscal Year 2006 Eligible Countries," 8 November, 2005 [http://www.mca.gov/public_affairs/].

[18] See: S. Lucas, S. Radelet, "An MCA Scorecard: Who Qualified, Who Did Not, and the MCC Board's Use of Discretion," Center for Global Development Working Paper, May 2004.

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

[20] S. Radelet, "A Note on the MCC Selection Process for 2005," Center for Global Development, 23 September, 2004, p. 5.

Table 2

GNI Per Capita for the CIS Candidate Countries in FY 2004, 2005 and 2006

FY04 CIS Candidates	GNI in 2002	FY05 CIS Candidates	GNI in 2003	FY06 CIS Candidates	GNI in 2004
Armenia*	800	Armenia*	950	Armenia	1,120
Azerbaijan	720	Azerbaijan	820	Azerbaijan	950
Georgia*	710	Georgia*	840	Belarus**	2,120
Kyrgyzstan	290	Kyrgyzstan	290	Georgia	1,040
Moldova	470	Moldova	470	Kazakhstan**	2,260
Tajikistan	180	Tajikistan	180	Kyrgyzstan	400
		Turkmenistan	850	Moldova	710
		Ukraine	780	Tajikistan	280
				Turkmenistan	1,340
				Ukraine	1,260
IDA ceiling	1,415		1,465		1,575

*Selected MCA Eligible Countries ** Lower middle income countries with GNI per capita of above $1,575 and below $3,255.

Source: *World Bank Development Indicators*, 2005.

tion and created anticorruption bureaus and instituted new laws, which do not necessarily lead to better governance outcomes.

It is believed that the administration granted eligibility to Georgia to support a geostrategic ally and a Western oriented President Saakashvili. Georgia was the first CIS country to replace the Soviet political elites by pro-U.S. oriented new leadership. Of course, while such a support of Georgia is justifiable from a U.S. foreign policy standpoint, it is not an appropriate use of MCA funds. Lucas and Radelet suggest that "the appropriate financial vehicle to support Georgia's transition is the State Department's Economic Support Fund, not the MCA."[21]

On 12 September, 2005, the MCC signed a five-year $295.3 million compact with Georgia to stimulate economic development in the poor regions, where more than half of the population lives below the poverty line. The program intends to benefit directly a half-million Georgians and quarter of the population of the country will benefit indirectly.[22] Apparently, granting an opportunity for Georgia to combat corruption and meet the objectives set by the MCA program is an investment into its future. At the same time, the MCC has been widely criticized for selecting Georgia in spite of its failure to meet the indicator test, which undermines the overall credibility of the MCA program.

[21] S. Lucas, S. Radelet, op. cit.

[22] See: MCC Press Release, "Millennium Challenge Corporation Signs $295.3 Million Compact with Georgia," 12 September, 2005 [http://www.mca.gov/public_affairs/].

Table 3

Performance of the CIS Countries in FY 2005

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

In terms of the ranking of other CIS countries in FY 2005, Ukraine and Moldova were high performers. Ukraine and Moldova passed all criteria except corruption. No doubt that Moldova would benefit immensely from receiving MCA funds because, despite its strong performance, it still has income per capita closer to the countries in Central Asia and the Caucasus. In terms of weak performers, Turkmenistan, Tajikistan and Azerbaijan ranked the lowest on most indicators. Turkmenistan was the worst case scenario, scoring "substantially below" on all "ruling justly" indicators. It also had missing data on two of the "investing in people" and "economic freedom" indicators. Tajikistan failed on all "ruling justly" and on five of the "economic freedom" indicators. Azerbaijan failed on all "ruling justly" with equal to the median indicators of rule of law and civil liberties. In Azerbaijan, it also took 123 days to start a business which is a substantial impediment to commence a business activity.

Overall, "ruling justly" and corruption were the most challenging barriers for the CIS countries in FY 2005. Half of the countries could not perform above the median on at least half of the "ruling justly" indicators. While Armenia, Georgia, Moldova and Ukraine managed to pass "ruling justly" category, only did Armenia pass the corruption hurdle.[23] The control of corruption index is an aggregate gauge of bribery, the costs of corruption in doing business and the capture of the state by vested interests. These are the characteristics of corruption pervasive in all of the CIS countries with particular intensity in Central Asia. It is important to note that corruption is not only a symptom of weak governance but is also a hindrance to governance reforms. In an environment of rampant corruption, it is also much harder to jumpstart demand for governance reforms.

Ranking of the CIS Countries in FY 2006: Median per capita income in the CIS has increased by 45 percent while the minimum income requirement has increased by ten percent from FY 2004 to FY 2006. In FY 2006, two additional CIS countries (Kazakhstan and Belarus) are added under the category of "lower middle income" (LMIC) countries. Thus, except Russia and Uzbekistan, all CIS countries are MCA candidates in FY 2006.[24] For FY 2006, the MCC has again determined Armenia and Georgia as MCA eligible. In addition, it has added Kyrgyzstan, Moldova and Ukraine

[23] Kyrgyzstan had equal to the median and Moldova and Ukraine fell slightly short of the median.

[24] Except Russia, which has a GNI per capita of $3,410, which is higher than the minimum requirement of $3,255 and Uzbekistan, which is subject to Section 577 of the FY2005 Appropriations Act, all of the CIS countries can compete for the MCA funds (see: MCC Report FY06, "MCA Report on Countries That Are Candidates for Millennium Challenge Account Eligibility in Fiscal Year 2006 and Countries That Would Be Candidates but For Legal Prohibitions." MCC Public Document on Identification of Candidate Countries, 2005 [http://www.mca.gov/countries/selection/index.shtml]).

to participate in the MCA threshold program for FY 2006. These countries, especially Armenia, Moldova and Ukraine, are also the top performers among the CIS countries on most selection indicators (see Table 4).

The CIS MCA Eligible Countries (Armenia and Georgia): Armenia scores higher than the median on 12, equal to the median on two and lower than the median on two out of 16 indicators. It does not fall "substantially below" on a single indicator. It has a strong showing on nine indicators with a clear advantage on "ruling justly" category in relation to its peer CIS countries. With regard to the progress from FY 2005 to FY 2006, it has invested more in education, with improvements in girls' primary education completion rate and education spending. Nevertheless, two indicators on which it still fails are in the category of "investing in people." In the area of governance, it has higher scores on government effectiveness and control of corruption. Yet, democracy indicators deteriorated within one year. John Danilovich has expressed his concern about lack of transparency and commitment to fair elections in the recent referendum in Armenia.[25] The MCC has promised to monitor closely Armenia's political process with a penalty of withdrawal in case its performance deteriorates further.

Georgia performs strongly on five indicators with particularly strong showing on democracy indicators. Because of the drastic efforts of the new government to undertake bold steps to fight corruption and improve governance, it has made the grade on the "ruling justly" category and advanced on most "economic freedom" indicators. It has also managed to improve on the most challenging

Table 4

Performance of the CIS Countries in FY 2006

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

Note: LIC = Low Income Category, LMIC = Low Middle Income Category.

Source: The calculations are based on the data from the MCA Country Ranking Dataset FY 2006.

[25] See: MCC Press Release. "Millennium Challenge Corporation Board Approves Armenia Compact but Expresses Concern Regarding Irregularities in the November Referendum," 19 December, 2005 [http://www.mca.gov/public_affairs/].

corruption hurdle from FY 2005 to 2006. Yet, it still comes short of the median and performs worse than Moldova and Ukraine. It is also vulnerable in the category of "investing in people." For instance, though health indicators have improved, primary education completion rate for girls has worsened and primary education expenditure is below the 20th percentile. Obviously, despite the progress, Georgia must do more to justify its being eligible for reasons other than its ranking on the selection indicators.

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

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

In *Kyrgyzstan*, like in most CIS countries, the main challenge remains "ruling justly." It simply fails all "ruling justly" indicators but without "substantially below" scores. Government effectiveness and civil liberties are equal to the median and control of corruption is marginally less than the median. In view of its very weak performance on "ruling justly" indicators, the choice of Kyrgyzstan as a threshold country has been subject to criticism. For instance, Radelet has written, "Kyrgyzstan just has no business being a threshold country. It passes zero of the governance indicators—none—and scores particularly poorly on all the democracy related indicators."[26] As Kyrgyzstan does not have sound scores on the "ruling justly" category to be competitive in the next rounds and experts have rightly brought up the issue, the MCC has not provided a detailed explanation for selecting Kyrgyzstan as a threshold country. There might be several reasons why Kyrgyzstan has been chosen as a threshold country.

First, in spite of weak democracy scores in relation to other MCA candidate countries, Kyrgyzstan is often called the "Island of Democracy" with more or less vibrant civil society and freedom of press in comparison to its neighboring authoritarian regimes in Central Asia. Following Georgia and Ukraine, Kyrgyzstan has recently gone through its own "Tulip Revolution," which signifies a change in the long-standing political leadership. The MCC might have decided that Kyrgyzstan has the post-revolutionary momentum to initiate drastic governance and democratization reforms, as it has been the case in Georgia. As Daniel Fried, Assistant Secretary for European and Eurasian Affairs, has stated, "There has been this year a major democratic advance in Kyrgyzstan where the newly elected leadership, elected in the fairest, freest elections that region has seen, is struggling with reforms."[27] Thus, the MCC might have expressed its generosity to support the newly elected Kyrgyz leadership in the same fashion it has supported Georgia. However, will this generosity transform into real institutional

[26] S. Radelet, "FY06 Threshold Countries—Some Disturbing Choices," MCA Monitor Bloc, 15 November, 2005 [http://blogs.cgdev.org/mca-monitor/].

[27] State Department, "Briefing on Secretary Rice's Upcoming Trip to Central Asia and Afghanistan," Washington, DC, October 2005 [http://www.state.gov/p/sa/rls/rm/2005/54624.htm].

and policy outcomes is a matter of time and political will of the newly formed Kyrgyz government. At this point, the new government is struggling to restore stability and order and it is hard to predict, which way it chooses to move forward.

Second, the MCC might have supported Kyrgyzstan because it has been a very strong political ally of the U.S. and hosts the only U.S. military base in Central Asia in between China and Russia and with proximity to Afghanistan. If this were factored in the decision-making of the MCC, then the so-called independence of the MCC from the U.S. government is very doubtful and this undermines the credibility of the program.

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

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

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

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

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

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

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

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

Conclusion: Governance is the Main Challenge in the CIS

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

Most other CIS countries are not likely to qualify for the MCA funds in next rounds given their very poor ranking on governance indicators. Overall, poor governance and pervasive corruption are the main challenges across the CIS region. For instance, while, in FY 2005, the CIS as a region performs above the median on all "investing in people" and on five of the "economic freedom" indicators, it fails on seven of the indicators from the WBI Global Governance Indicators Database (see Table 5). In FY 2006, once again, the governance indicators are the most challenging barriers. Out of eleven CIS countries, seven fail "ruling justly" and regulatory quality indicators. Ten countries fail the corruption test and most CIS countries rank low on the voice and accountability and rule of law indicators, meaning that citizens in the CIS not only lack civil liberties, independent media, and equal opportunity to participate in the selection of government officials but they also lack confidence in the laws, judiciary and enforceable contracts.

Table 5

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

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

*In FY 2006, the Costs of Starting a Business is used instead of the Country Credit Rating.

Note: > above the passing score, < below the passing score, = equal to the passing score, P = passed and F = failed.

Source: Calculations are based on the data from the MCA Country Ranking Dataset FY 2005 & 2006.

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

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