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## Can Foreign Aid Give an Incentive for Good Governance? The Case of the Millennium Challenge Corporation in Jordan

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***Can Foreign Aid Give an Incentive for Good Governance  
Reform? The Case of the Millennium Challenge Corporation in  
Jordan***

A thesis submitted in partial fulfillment of the degree  
of Bachelor of Arts in Government from the College of William and Mary

by

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## **Annotated Table of Contents**

### ***Abstract***

This study of the Millennium Challenge Corporation's (MCC) involvement in Jordan has the following objective: to determine whether the MCC can create an incentive for good governance and hold countries to a higher level of institutional scrutiny through aid disbursement. Through interviews with MCC officials in Washington, D.C. and government officials in Jordan, this paper shows that both the MCC and the Jordanian Government act strategically in pursuit of their interests, and this significantly shapes the strength of the incentive effect. The author uses a principal-agent model of behavior to examine the relationships between these organizational actors and within the organizations themselves. He also examines the dynamics of political survival in Jordan through rent-seeking behavior. A two-level game is developed from this analysis to model donor-recipient interactions within this important contemporary case study.

## **Part I: Introduction and Background**

### ***Chapter 1 – Incentives, Credibility, and Strategic Behavior: An Acclimation to the Millennium Challenge Corporation in Jordan***

The introduction first offers a vignette about Jordan's elections in order to shed light on the political dynamics of this case. The chapter then introduces the reader to the Millennium Challenge Corporation and its novel method of aid distribution using pre-aid incentives. This chapter begins with the following premises: both the MCC and Jordan are strategic actors that make various strategic decisions, and these decisions can affect the strength of this incentive effect. After clarifying the method and levels of analysis, this chapter serves as a compass for the rest of the study. First, a background of the main actors is provided such that the reader is equipped for the data chapters to follow. Afterwards, a brief overview of the main theoretical framework of this thesis, principal-agent theory, is provided, as well as a background on rentierism for use in the analysis of Jordan found in Chapter 4.

### ***Chapter 2 – U.S. Foreign Assistance to Jordan in Institutional Perspective: Agency and the Deconstruction of Actor Preferences***

This chapter outlines the theoretical approach of the paper -- principal agent theory -- that is used to explore behavior and strategic interactions between actors. The idea of collective principals is introduced in the case of the MCC Board of Directors. The concepts of delegation and oversight of principals on agents are used to describe the relationship between the MCC and Jordan, and the author establishes both the MCC's indicators of good governance and the Threshold Country Plan (TCP) grants as ways to oversee compliance and deviance within recipients. Finally, the chapter introduces rentierism as a way to understand the strategic political actions of Jordan in light of potential MCC funding.

## **Part II: Data and Interviews**

### ***Chapter 3 – The Millennium Challenge Corporation as a Strategic Actor: The Board of Directors***

This chapter presents data in the form of interviews with MCC officials involved in the selection and disbursement process. Interviews with staffers at the MCC reveal that there exist divergent preferences within the Board of Directors. Further interviews with advisors to MCC board members reveal these preferences more fully. The key finding is that MCC board members often favor actions that may undermine the strength of the MCC incentive effect.

#### ***Chapter 4 – Jordan as Strategic Recipient: the Short and Long-Term Effects of Aid-Seeking***

Paralleling the data collection from Chapter 3, this chapter compiles interview data both on the general manner that Jordan reacts towards potential aid funding, and the specific treatment of a potential MCC aid compact. These interviews reveal the strategic behavior of Jordanian actors with regard to both the MCC good governance indicators and the MCC Threshold Country Plan grant awarded in September 2006. As mentioned in Chapter 2, the Threshold grant serves as a litmus test of compliance for the MCC. This analysis demonstrates how Jordan strategically reacts to aid funds under different circumstances. Jordan often complies in the short-term, but is tempted to drift from initial commitments in the long-term as levels of oversight decrease and more politically viable alternatives become more attractive.

### **Part III: Analysis and Model**

#### ***Chapter 5 – A Model of Strategic Actions during the Aid Transaction: Credibility, Cheating, and Strategic Planning***

Having explored the preferences and behavior of both donor and recipient, this chapter draws some tentative conclusions about the patterns of strategic behavior apparent in the Jordanian case. The author makes some key assumptions based on the conclusions drawn from Chapter 3 and 4 data, and develops a model of strategic behavior in the form of a two-level game between donor and recipient. This game is informed by the credibility of the MCC's oversight mechanisms and the potential for Jordanian policymakers to cheat. If the incentives provided by the MCC outweigh the disincentives for Jordan to cheat, then the incentive effect is strong given a credible commitment by the MCC. The multiple equilibria of this game are highly dependent on the preferences of the recipient country's selectorate: the most likely result for potential recipients is a policy that adheres to donor preferences when oversight is high, and a deviance from these preferences when oversight is low and other politically advantageous alternatives are available.

### **Part IV: Conclusions**

#### ***Chapter 6 – Concluding Thoughts***

This chapter concludes that the MCC incentive effect is real and most observable in Jordan in the short term. This incentive effect can endure as long as some type of credible commitment is exhibited by the MCC, usually in the form of effective oversight and political pressure. However, in the long term, it is more difficult for the MCC incentive effect to remain strong because of the domestic pressures in Jordan to deviate from its original commitment. These preferences of the Jordanian Government are dictated in large part by the domestic selectorate, which has substantial power to shape policy. The dynamics of this strategic interaction are present and apparent in Jordan because Jordan is a country that is on the margin: it is a strategic actor that potentially may benefit from the discretionary authority of the MCC Board of Directors. Jordan is cognizant of the Board's discretionary authority and uses this knowledge to strategically shape its domestic policy decisions.

This study adds to our understanding of the MCC's ability to incentivize good governance even before aid is sent, and asserts that future studies on the effect of different aid initiatives should make more of an effort to consider the strategic behavior of actors more fully, as this is lacking the literature.

### ***List of Acronyms***

CRS – Catholic Relief Services, *a Catholic based NGO focused on Humanitarian aid*  
GNI – Gross National Income  
GoJ – Government of Jordan  
IAF – Islamic Action Front, *the main opposition party in Jordan*  
IGM – Independent Governance Monitor, *i.e. Freedom House, Heritage Foundation*  
IMF – International Monetary Fund  
IRI – International Republican Institute, *a Washington-based non-profit organization*  
MCA – Millennium Challenge Account  
MCC – Millennium Challenge Corporation  
MOPic – Ministry of Planning and International Cooperation in Jordan  
NED – National Endowment for Democracy  
NGO – Non-governmental Organization  
NSC – National Security Council  
PA – Principal-Agent  
PM – Prime Minister  
TCP – Threshold Country Plan, *a smaller type of MCC grant*  
UNESCO – United Nations Educational, Scientific, and Cultural Organization  
USAID – the United States Agency for International Development  
USTR – United States Trade Representative

## **Chapter 1**

### ***Incentives, Credibility, and Strategic Behavior: Acclimation to the Millennium Challenge Corporation in Jordan***

*A Vignette: The Millennium Challenge and Good Governance Reform in Jordan*

Flying ten thousand feet above the heart of the Middle East in August of 2007, I eagerly anticipated my return to Amman, Jordan to visit the family that hosted me during my last stay one year earlier and to carry out more research on the political development of Jordan. In the fall of 2006, I had stayed in Jordan for a five month stint of study and research, during which time I was hosted by a family of Palestinian origin, the Shurufas. Sitting in the plane shortly before landing, I recalled my impressions of the family who took me in earlier that year. The three children were now all in their twenties and shared many of my concerns about Jordanian institutions and prospects for reform. The oldest son, clearly the most passionate and informed about the political development of his country, was waiting for my arrival to share his observations on the development process. I was especially eager to hear his impressions on the municipal elections that occurred one day earlier, for these elections were the first time that the Jordanian government allowed all officials to be locally elected rather than appointed by the monarchy.

The local election reform that had passed through the Jordanian parliament in February of 2007 was part of one of the programs delineated from a Millennium Challenge Corporation Threshold Country Plan Grant, approved in September 2006. Threshold Grants are intended to provide “good faith” start-up money for countries that have not quite reached competency on enough of the seventeen indicators of good governance. Jordan’s shortcoming on the MCC indicators fell in three main areas: Political Rights, Voice and Accountability, and Trade Policy. One of the main requirements of the Threshold Grant was to extend full elections to all Jordanian

municipalities in the next local election; up until that point, half of all local councils and all mayors were appointed by the monarchy.

In November 2006, the Millennium Challenge Corporation made the announcement that Jordan was one of the countries eligible for compact status, two months after the announcement in September that Jordan was deficient in three aforementioned indicators. My interviews with both the aid workers on the ground in Jordan and the USAID Jordan staff charged with subcontracting the original Threshold grant told of the confusion they felt when the November announcement came. My first impression was that the Jordanian government now had a free pass to deviate from the preferences of the MCC (now that Jordan was indeed compact eligible). I was reassured by members of the Jordanian government, however, including the democracy officer at the Jordanian Ministry of Planning and International Cooperation that the Jordanian Government would proceed with democratic reforms as planned, although he mentioned they must first pass parliament approval. The local governance initiative passed parliament with the one exception that Amman, the capital, should be exempt from the law because Amman was following its own development paradigm. The Jordanian government, therefore, slated the August municipal elections to be carried out as a full election, as per the requirements of the MCC.

Upon my return, my host brother Sharif showed me a video of the election results in the town next to Amman, named Madaba. The videotape showed buses of men dressed in civilian clothing, which, he told me, were government employees and soldiers. Madaba was one of the most contested electoral districts where the pro-monarchy candidate was expected to lose to a candidate from the Islamic Action Front (IAF), the political wing of

the Muslim Brotherhood. Sharif recounted that these government employees were brought in because the monarchy knew they would lose a seat otherwise. The IAF subsequently withdrew all their candidates before the polls closed, and issued statements denouncing electoral fraud in several districts.

I was shocked to hear of such blatant electoral fraud in what was supposed to be a fledgling democracy. In the days that followed, I attempted to contact members of government who could confirm or refute these observations, but none responded. Official Jordanian news sources communicated that the IAF pulled out after checking preliminary exit polls which reflected their likely defeat. After weighing the reports on all municipal elections in Jordan, the United States Ambassador to Jordan declared the election “free and fair,” and the Jordanian Government applauded the elections as “a step in the right direction for Jordanian democracy.”

Later that month, the Washington Institute for Near East Policy released their report on the Jordanian elections. In this report, the Institute acknowledged that these elections were the first time that the government actively aided soldiers in going to the polls. However, the report concludes that, “it is impossible to know exactly what happened in those disputed electoral districts.”<sup>1</sup> According to Jordanian law, government officials were allowed to vote in any district they chose, and they happened to vote in the regions which pro-monarchy candidates were in the most need. The Jordanian elections were not fraudulent outright, but the electoral process did not go smoothly. Furthermore, the only real opposition to the pro-monarch candidates came in the form of the IAF candidates that withdrew their candidates.

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<sup>1</sup> David Schenker. “The Islamist Boycott of Jordanian Municipal Elections: A Victory of Public Relations or Politics?” The Washington Institute for Near East Policy, Policy Watch Paper #1269, August 7, 2007. Available at: <http://www.washingtoninstitute.org/templateC05.php?CID=2645>.

In the past, regimes throughout the Middle East have systematically tried to limit the Islamists political power and participation in government. The IAF, for example, has clear ties to the Palestinian political party, Hamas, and the Jordanian Government finds it sometimes necessary to curb political freedom in order to ensure that an illiberal organization does not rise to power. However, this has a large effect on public sentiment on democratic prospects. For example, Sharif, when asked about the state of democracy in his own country, understands the uniquely difficult situation Jordan faces. “We have two choices on radically different sides of the spectrum: the pro-monarch proponents representing the status quo, and the Islamists advocating radical change...and then one withdraws. What real choice is there?”

In truth, Jordan faces a long process in moving towards democracy, even with the potential help of the MCC. There are clear cultural barriers impeding the development of a sound political culture complete with liberal political parties and full participation. However, the United States is currently continuing its efforts to promote good governance reform in Jordan through the MCC. The following chapters, therefore, will shed new light on the efforts and motivations of the Jordanians and those at the MCC in an attempt to determine whether or not the existence of the MCC and the possible funds they offer serve as enough incentive to change the behavior of the Jordanian Government. Will enough good governance reforms take hold such that the MCC will award Jordan with a fully signed and developed compact? Will Jordan make the effort?

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### *Acclimation to Paper*

In 2002, President Bush changed the trajectory of U.S. foreign aid policy during a speech at the Inter-American Development Bank by proposing to increase the country's foreign aid budget by \$5 billion and creating the Millennium Challenge Corporation (MCC). During this speech, President Bush cited the fundamental differences between aid giving through the MCC and that of traditional aid agencies. MCC funds are only meant for countries that are committed to good governance—as currently measured by seventeen independently compiled indicators.<sup>2</sup> With the MCC, Bush hoped that U.S. foreign assistance would be more effective and transparent (due to its implementation by more transparent and accountable governments). Additionally, the possibility of MCC funding would create an incentive for developing countries to improve their political and economic institutions even before the MCC allocated any development assistance.<sup>3</sup>

This paper deconstructs the actions of the MCC and its potential recipients to see if this novel method of aid allocation works as intended. Can the MCC create an incentive for good governance and hold countries accountable to a higher level of institutional scrutiny? In order to answer this question two issues must be addressed. First, does the MCC disburse aid exclusively on how a country performs on good governance indicators, or do other factors, such as geopolitical and commercial interests, play a large role? The divergent preferences of the MCC decision-makers as well as the ability of the MCC to adequately ascertain a recipient's performance on indicators play

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<sup>2</sup> Originally, the MCC outlined sixteen indicators of good governance at its inception in 2004. The MCC has had ongoing open debates over improving and adding to these indicators throughout its existence. This process has resulted in a shift from a "primary education completion rate" indicator to a "girls' primary education completion rate" indicator, the addition of the "land rights and access" and "natural resource management" indicators, and the dropping of the "country credit rating" indicator.

<sup>3</sup>Bush, George W. March 15<sup>th</sup> 2002. Contents of Speech Given at Inter-American Development Bank. Available at [www.whitehouse.gov/news/releases/2002/03/2002314-7.html](http://www.whitehouse.gov/news/releases/2002/03/2002314-7.html)

key roles in this analysis. Second, do recipients pay attention to the MCC's disbursement rules and thus change their governmental and economic institutions in response? This effect may vary between recipient countries, depending on the value each recipient places on foreign aid funds.

A prior study by Johnson and Zajonc (2006), has examined the MCC incentive effect over potential recipient countries by examining the changes in governance indicators before and after the MCC creation. They find that, on the whole, potential recipients have shown improvement in their indicators since the creation of the MCC. While this gives observers an overall idea of the potential effect of the MCC, it does not illuminate what factors contribute to the strengthening or weakening of the effect. This study will focus on these factors both within the MCC and in recipient countries.

This paper will examine the MCC's involvement with the country of Jordan. Jordan, a lower-middle income country as categorized by the World Bank, is a prime candidate for U.S. development resources for governance reform. It lies in the heart of the Middle East, a region the U.S. government has identified as one in dire need of democratization. The Bush Administration is looking for a Muslim country to serve as a "beacon of democracy and freedom" in that region, especially in light of the recent struggles in implementing democratic institutions in Iraq. Jordan has long been a recipient of U.S. assistance through the United States Agency for International Development (USAID), and is now a compact-eligible country with the MCC.

In the case of Jordan and the MCC, this study will examine the role and scope of the MCC's influence on Jordanian policymaking and institutional reform. Has the MCC been able to incentivize good governance as its creators intended and its proponents

argue? Does the MCC exert a meaningful influence over the economic and political decisions in Jordan before aid is sent? One approach to answering this question is to choose to make explicit the ideal implications of the MCC incentive effect if it were to hold perfectly, and observe what the results from Jordan show after seeking MCC funds. However, while such an analysis mirrors the research design for the Johnson and Zajonc (2006) paper, Johnson and Zajonc fail to take into account the micro-level decision-making processes in the MCC and recipients. The MCC incentive effect does not exist in a vacuum; rather, the actions and motivations of the recipient are necessary in our analysis.

We can conceive of the interactions between the MCC and Jordan as a two-level game between actors. The strategic actions of recipients in response to pressure from both the MCC and the selectorate<sup>4</sup> of their country dictate the strength of the MCC incentive effect on good governance. The first game is dependent on the decision and the justification of the MCC for awarding Jordan MCC funds. If the MCC approves a grant, and this approval is based heavily on Jordan's performance on governance indicators, the incentive effect will be strong. If the approval is based more on strategic, commercial, or domestic political reasons within the U.S. government, then the incentive effect is much weaker and the prospects for substantial governance reform in Jordan will be low. In the second game, the decision of Jordan to seek MCC funding and the extent that they are willing to implement actual reform is the dependent variable. By observing the behavior and actions of Jordanian government officials in response to MCC prospective funding

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<sup>4</sup>The selectorate is the set of people who have an institutionally granted say in choosing leaders, indirectly influencing policy, and potentially removing leaders from office. An in-depth discussion of the selectorate is found in Chapter 2 (pg. 34).

and the demands of their selectorate, the strength of the MCC incentive effect can be observed more clearly.

These two games are placed together in the same analysis because the outcome in each game is shaped by the outcome in the other game. A key variable that shapes the interaction between the games and thus dictates the end result is the credibility of actor commitments. I conceive of the MCC as a strategic actor that selectively chooses recipient countries and attempts to hold such countries to a high standard of good governance. However, the MCC often suffers from credibility problems. Specifically, because recipients are well informed about the strategies and motivations of potential donors, they realize they might be able to get money while avoiding the costly or politically risky reforms that donors sometimes require. If the recipient believes that the donor cannot credibly hold them accountable for “cheating,” then the recipient will be less likely to implement the MCC’s good governance reforms and are more likely to sustain the status quo level of governance. However, the *extent* to which recipients cheat is also important: if Jordan fails to adhere to MCC rules to a large extent, the MCC is left with no choice but to enforce its own rules and renege on its conditional commitment to disburse funds.

Furthermore, I argue that the possibility of cheating is not solely indicated by the dynamics of this aforementioned two-level game. Rather, the *recipient’s treatment of past aid transfers is a good predictor of potential treatment of future MCC funds*. Therefore, recent aid flows to Jordan can serve as a further indicator of the likelihood of a MCC incentive effect. This implication has further consequences as the MCC has two types of grants: one smaller grant program (Threshold Program) that awards monies to countries

that nearly qualify for full assistance but have some deficient indicators, and a full MCC Compact grant for countries that qualify outright. I argue that the Threshold Program and similar forms of aid targeting “good governance” deficiencies serve as *litmus tests* for good governance.

This opening chapter attempts to orient and organize this study in three ways. First, it clarifies the particulars of the Millennium Challenge Corporation’s structure and function such that the mechanisms of country selection and fund allocation are clear. Second, it provides a brief overview of the theoretical framework necessary to understand the decision-making determinants of both the donor and recipient. Finally, the introductory chapter provides a point of departure to frame the case study of Jordan. Here, readers can intuit a sense of the themes and dynamics at work in Jordan before being thrust into the heart of the case study in later chapters.

In this thesis I attempt to do four things. In chapter 2, I provide the reader with the theoretical tools necessary to understand the actions of the MCC’s board of directors, as well as the concepts critical in understanding the domestic decision-making process in Jordan as it relates to foreign aid and the MCC. In chapters 3 and 4, I present the interview and observational data on the decision-making process at the MCC and in the Jordanian government respectively. Here, I present interviews with key officials in both the MCC and Jordan, and I use the frameworks presented in the second chapter to help explain the motivations of both actors. In chapter 5, I explore the dynamics of the interaction between these two “games” by presenting a model that articulates a continuum of possibilities on the part of the MCC and Jordan. The outcome along this continuum is dependent upon the credibility of the MCC in enforcing its own “good

governance” rules. In Chapter 6 I draw conclusions from the model and discuss the lessons from the Jordanian case that might help us to understand the effects of the MCC in other cases.

### ***Background***

Both academic and casual observers of American Foreign Policy have consistently reflected upon a pervading theme over much of the 20<sup>th</sup> and 21<sup>st</sup> centuries: that the United States could enhance its own security and welfare by encouraging other countries to adopt democratic institutions. This overarching theme permeates policymaking circles, from National Defense to aid and development. Many involved in U.S. Development aid policy, therefore, argue for a critical focus on the development of democratic institutions and civic engagement. The rationale of this approach to aid allocation is that aid is more sustainable when developing countries adopt best practices that can be sustained and improved through accountability with the recipient government’s own voting population.

This key shift in U.S. policy with the creation of the MCC is the motivating factor for this current study. Unlike other major aid organizations that use conditionality as a main tool of aid disbursement, the MCC utilizes a device that has been largely lacking in other methods of aid allocation: incentives. Incentives have long been stressed as critical in economic terms to play towards an individual’s (or in this case, a government’s) rational choice, and using incentives correctly can minimize deviant behavior in an aid recipient country. While incentives have been used by the World Bank and International Monetary Fund (IMF), both organizations apply incentives and conditionality only after aid is initially sent. The MCC, on the other hand, applies incentives before aid is even

sent. The resulting MCC incentive effect is a cornerstone of its method of distribution as championed by MCC CEO Ambassador John Danilovich:

MCC approaches development more like an investor than a traditional donor: we partner with countries that *want* to leverage MCC assistance to further their *own* commitment to reduce poverty and stimulate growth, *not* act as a substitute for it. And, as an investor, we demand results from our investment. We see countries take on the incredible work of policy reforms to qualify for our assistance and, then, to maintain their eligibility. Our model has become a powerful *incentive* to reform, what is often referred to as the “MCC effect.”<sup>5</sup>

In light of the recent and fervent arguments both for an overall increase in aid<sup>6</sup> and a refocusing on the proliferation of democratic norms and reforms in developing societies, this study looks to assess the second rationale of the shift to the MCC: the possibility of the MCC creating an incentive effect. Specifically, two questions emerge as focal points for this study. First, does the existence of the MCC and the possibility for future aid funds prompt potential recipients to reform before funds are sent? Second, if the MCC does create such an incentive effect, what roles do the donor, recipient, and the dynamics of the aid transaction each play in ensuring the efficacy of the incentive effect and therefore the prospects for real and sustained governmental reform?

These two questions are quite novel due to the recent emergence of the MCC, which gave its first aid compact in 2005 and has only just begun to apportion aid on a larger scale. Its budget for 2007 was 3 billion dollars, as opposed to the roughly 2.7 billion dollars apportioned to USAID for development purposes.<sup>7</sup> Therefore, the

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<sup>5</sup> John Danilovich. February 4, 2008. “How MCC offers a Smart Power approach to America’s Global Engagement.” Remarks at the Center for Strategic and International Studies (CSIS). Available at: <http://www.mcc.gov/press/speeches/documents/speech-020408-smartpower.php>

<sup>6</sup> See, among others, Sachs (2005).

<sup>7</sup> While roughly 2.7 billion dollars was apportioned to USAID for development purposes, USAID also has budgets for Humanitarian Relief, Agriculture subsidies, and has a shared budget with the U.S. Department

increasing scope of the MCC in spite of its relatively recent establishment warrant an in-depth examination of its activities, evaluating the real movements to reform in potential recipient countries on an individual case basis. Previous studies of the MCC incentive effect have attempted to compare large-N empirical data of potential recipient country behavior both before the existence of the MCC and after its creation. While past studies are excellent at establishing overall trends in potential aid effects, the examination of a larger sample rather than individual cases fails to open the “black box” of actors. This thesis offers answers to questions about the mechanisms involved with the MCC disbursement process through a detailed case study.

Specifically, the following questions are examples of what the aid community often fails to address in their assessments: what actions and preferences by the donor country (the United States) can influence the extent of success or failure in a recipient government? What unintentional (predisposed) or strategic behavior by a recipient country can lead to successful and unsuccessful manifestations of the incentive effect? Finally, how do the dynamics of the transaction between donor and recipient contribute to the potential success or failure of reform through an incentivized aid package? These are puzzles about which large-N analyses can only hypothesize, but in-depth analysis can confirm or refute on a case-by-case basis.

The following chapters seek to address these three puzzles as part as the overall question of whether the MCC does create an incentive effect, and if it does, how it manages such an effect successfully. This study uses the case of the Hashemite Kingdom of Jordan’s recent relationship with the Millennium Challenge Corporation as the main point of departure for many of the observations made about the three areas of

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of State. When added to the Development budget, USAID’s total budget for 2007 was roughly 9.34 billion.

examination: donor behavior, recipient behavior, and the dynamics of the transaction. Jordan, a lower-middle income country as categorized by the World Bank, is a prime candidate for U.S. development resources for democratic reform. It lies in the heart of the Middle East (sharing borders with Iraq, the West Bank, Syria, Lebanon, Israel, Egypt, and Saudi Arabia), a region that the United States desperately needs a democratic country to emerge as a “beacon of democracy and freedom.”<sup>8</sup> The ramifications of successful democratic reform in Jordan are far-reaching. In addition to the aforementioned “public goods” and “public ills” externalities for the international system, a democratic Jordan would serve as a model for democracy in the Middle East (often thought to be very difficult by critics of Arab institutions of governance) and would be a potential staging ground for U.S. work in each of its proximate countries.<sup>9</sup>

### ***The Millennium Challenge Corporation***

In considering the effectiveness and scope of the MCC in its current state, it is valuable to take survey of the insights leading to its creation. The empirical and theoretical justifications both in favor and against this shift in U.S. international aid policy to the MCC are abundant and combative. Two main assessments are integral in establishing a relationship between good policies and growth and are critical in justifying the shift in policy: a 1998 World Bank report *Assessing Aid*<sup>10</sup> and a 2000 paper by Craig

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<sup>8</sup> Interview: Ghaith Zureikat. Jordanian Ministry of Planning and International Cooperation (Amman), November 21, 2006.

<sup>9</sup> For more on the potential ramifications of a successful democracy in Jordan, see among others: Ronald Inglehart and Pippa Norris. “The True Clash of Civilizations,” *Foreign Policy*, 135 (Mar-Apr. 2003), pp. 62-70.

<sup>10</sup> David Dollar and L. Pritchett. *Assessing Aid: What Works, What Doesn't, and Why*. New York: Oxford University Press, 1998.

Burnside and David Dollar from the World Bank entitled “Aid, Policies, and Growth.”<sup>11</sup> According to Burnside and Dollar, aid is most effective when invested; the incentive to invest and the productivity of aid investments, however, are diminished by “various policy distortions that can lower the return to capital.” In layman’s terms, they assert that aid, when distributed to countries with sound policy environments, *causes* growth.

Both the 1998 World Bank report and the 2000 Burnside and Dollar findings have been often disputed for their robustness and validity. In a response to the Burnside and Dollar findings, William Easterly, Ross Levine, and David Roodman prepared a response in 2004, using the same data as Burnside and Dollar but expanding the sample size and adding cases not used in the 2000 study.<sup>12</sup> They find that there is no observable relationship between aid and growth. A 2005 follow-up study by chief economist at the IMF, Raghuram Rajan, and IMF researcher Arvind Subramanian retested the Burnside-Dollar hypothesis and also found no evidence to support their assertions.<sup>13</sup>

As the results are unclear about the relationship between aid and growth, so too are the results on the relationship between aid and democracy. In the 1960s and 70s, project-level aid had limited success due to the corrupt or inefficient governments of recipient countries. The realization that the success of foreign aid is dependent on good economic and political institutions led to era of “structural adjustment” in the IMF and World Bank, in which *ex ante* conditional aid, or aid sent only if the recipient country agreed to reform, was introduced.

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<sup>11</sup> Craig Burnside and David Dollar. “Aid, Policies, and Growth,” *The American Economic Review* 90:4 (Sept 2000), pp. 847-868.

<sup>12</sup> Easterly, William, Ross Levine and David Roodman. 2004. .Aid, Policies, and Growth: Comment. *American Economic Review* 94(3):774.780

<sup>13</sup> Raghuram Rajan and Arvind Subramanian. “Aid and Growth: What does the Cross-Country Evidence Really Show?” IMF Working Paper 05/127 (2005). Available at: <http://www.imf.org/external/pubs/ft/wp/2005/wp05127.pdf>

While structural adjustment seemed to be the golden egg of aid theorists, the theory fell on its face when put into practice. Very few recipient countries showed any change in economic growth, or for that matter, any change in democratic governance (as many IMF recipient countries ended up becoming failed states).<sup>14</sup> In a relatively recent assessment of the relationship of foreign aid and democracy, Stephen Knack finds that neither conditionality nor specific programs aimed at fomenting democratic reform have any measurable effect on democratic indicators.<sup>15</sup> As Knack used large-N empirical analysis to draw his conclusion, it does not preclude the success of some, if not many programs. However, in the aggregate, there is no effect (negative or positive) on democracy according to his study.

### *The Structure and Function of the MCC*

Nonetheless, the landmark 1998 World Bank study and the Burnside and Dollar (2000) findings laid the groundwork for President Bush's move to create the Millennium Challenge Corporation. The MCC seeks to separate from the political motivations of aid by basing country selection, in part, on seventeen different policy indicators measuring three broad areas of governance: "ruling justly," "investing in people," and "economic freedom."<sup>16</sup> 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, to name a few. In order to be eligible for MCC funds, countries must fall within either the World Bank's "Low Income" or "Lower-Middle Income"

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<sup>14</sup> This delineation of the history of good governance in foreign aid is influenced by William Easterly. "How Will Greater Foreign Aid Help the Poor This Time?" *Heritage Lectures* 950 (July 13, 2006).

<sup>15</sup> Stephen Knack. "Does Foreign Aid Promote Democracy?" *International Studies Quarterly* 48 (2004), pp. 251-266.

<sup>16</sup> Millennium Challenge Corporation Website: [www.mcc.gov](http://www.mcc.gov)

categories, and must pass any nine of the seventeen indicators. However, the MCC requires countries to score above the median score in corruption as a pre-requisite.<sup>17</sup> During the final decision-making process, the MCC Board of Directors considers three main factors in determining a country's eligibility: a country's performance on the seventeen indicators, the opportunity to reduce poverty and generate economic growth within a country, and the availability of funds. Thus, while the selection criteria are critical components of determining eligibility, the selection indicators are not the only factors evaluated. The MCC Board has some discretion in country selection and compact approval, and this discretion has a direct effect on the MCC incentive effect.

#### *Recent Commentary on the MCC*

In his 2006 book *The White Man's Burden, Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, William Easterly questions the country selection process of the MCC, stating that empirical measures of good governance very seldom reflect the practice of governance in a country.

As of June 2005, the Millennium Challenge Corporation had reached agreements on aid programs with two countries—Honduras and Madagascar. In 2004, Honduras's government was ranked by the World Bank as among the worst third in the world for corruption. Madagascar is better; it is smack in the middle on corruption. But the other problem is that these corruption ratings are imprecise. The World Bank reports the margin of error of its estimate, and fifty-seven other countries lie within the margin of error of the Madagascar rating of corruption. The high margin of

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<sup>17</sup> When first created, the MCC only considered countries that fell within the "Low Income" band of wealth as found by the World Bank. However, once not enough candidate countries were found that were eligible for funding, the criteria was expanded.

error reflects the difficulty that different outside rating agencies have reaching consensus on which countries are more or less corrupt.<sup>18</sup>

Easterly's criticisms highlight a potential shortcoming of the MCC method of disbursement if indicators do not necessarily reflect the complete picture of a country's governance. However, the MCC promotes an ongoing process of refining and changing the selection indicators on a yearly basis. During this process, non-governmental organizations and private sector organizations can voice their opinions about the MCC indicators and suggest changes and alterations. Since 2004, the MCC has changed, added, and subtracted the selection indicators to measure a country's governance performance more accurately.

In terms of academic studies that study the existence of an incentive effect, the aforementioned 2006 working paper by Harvard economists Doug Johnson and Tristan Zajonc empirically studies the possibility of an incentive effect early in the MCC's existence.<sup>19</sup> Johnson and Zajonc's study examines the rate of reform of governance indicators both before the advent of the MCC and after its creation.<sup>20</sup> From a sample of 102 possible recipients, Johnson and Zajonc find that the MCC incentive effect is real as indicated by the change in behavior of potential recipient governments. While this establishes that the MCC has some positive effect in incentivizing good governance reform, it is unclear how this effect manifests itself in the data. Furthermore, the relatively short time frame from which to draw their data makes their claims only preliminary. In contrast to the Johnson and Zajonc study, this thesis delves into micro-

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<sup>18</sup> William Easterly. *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*. New York: Penguin Books (2006), pp. 156-157.

<sup>19</sup> Doug Johnson and Tristan Zajonc. "Can Foreign Aid Create an Incentive for Good Governance? Evidence from the Millennium Challenge Corporation" (April 11, 2006). Available at SSRN: <http://ssrn.com/abstract=896293>

<sup>20</sup> Johnson and Zajonc use a difference-in-differences approach to measuring the change in indicators, and their findings are statistically significant.

level manifestations of the MCC effect in Jordan to make clear the specific interactions and decisions of actors and to represent behavior in a systematic model of strategic action.

### ***Overview of Theoretical Framework***

This thesis utilizes Principal Agent theory (or Agency theory) as the underlying lens through which to analyze the behavior of a donor and recipient government and their interactions with each other and other “sub-actors” (subcontracting agencies, subcommittees and groups within the larger framework of the two governments).<sup>21</sup> The basic insight of Principal-Agent theory is that the preferences of the principal and the agent often diverge and cause delegation and accountability problems. In the context of aid allocation, when donor and recipient governments do not have the same preferences and are unable to coordinate these preferences successfully, the recipient is liable to redirect aid for its own purposes.<sup>22</sup> Furthermore, recipients and their respective bureaucracies try to maximize ways in which they can receive a large mandate, more responsibility, and increased funding in order to maintain and expand their own existence.

The divergence between actor preferences is exacerbated by intervening factors such as the perceived proximity of the principal (donor government) and the efficacy of oversight mechanisms. As the links between different stages in the delegation chain of aid increase and become less proximate, the greater the possibility of agency slack and

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<sup>21</sup> In Development literature, relations are described as problems with the fungibility of aid, or the extent to which the recipient can redirect aid to a new purpose. Principal Agent theory (PA theory) stems from the conceptualization of the firm. Landmark studies include Coase (1937). Of the other variants of firm theory, transaction cost theory of the firm is quite similar to PA theory, except argues that the firm, rather than the transaction, is the critical unit of analysis.

<sup>22</sup> This delineation is borrowed from: Bertin Martens, Uwe Mummert, Peter Murrell, and Paul Seabright. *The Institutional Economics of Foreign Aid*. Cambridge (UK): Cambridge University Press (2002).

slippage. Furthermore, as recipient governments receive greater scope in aid allocation and intentions, agents farther down the delegation chain will need to deal with multiple principals, involving mixed signals between the donor government (United States) and recipient government about desired results and methods.<sup>23</sup> This concept is important in order to understand how the Jordanian government gauges the strength of the MCC's scrutiny and then shapes its behavior in response to the perceived commitment of the MCC.

The basic skeleton of Principal-Agent Theory provides the opportunity to explore the factors that shape the preferences of donors and recipients more fully in a descriptive case study of Jordan. Each case has a distinct domestic policy environment that shapes recipient behavior, and this thesis uses the case of Jordan as a starting point for exploring the roles of preferences and credible commitments in the decisions of recipient governments. To examine the extent to which Jordan engages in "aid-seeking" behavior, this study utilizes the lens of "rentierism," or the reliance on external flows of capital on an economy or on government expenditure. Countries like Jordan that have received large levels of aid in the past may, over time, become dependent on aid as an input into the country's budget, and this dependency may shape their actions and preferences. Therefore, the theory of the rentier state serves as a specific lens with which to analyze the Jordanian government's actions. The rentier-state framework serves as an "arm" of the overarching agency framework of the whole study.

When considering the impact of aid on domestic politics, it is useful to assume that the government of a recipient country is a rational actor and therefore will look to

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<sup>23</sup> Daniel Nielson and Michael J. Tierney. "Delegation to International Organizations: Agency Theory and World Bank Environmental Reform," *International Organization* 57 (Spring 2003), pp. 241-276.

sustain its position of power. By nature, incumbent governments will use aid to the extent that it can help sustain a political advantage.<sup>24</sup> If aid is seen to be necessary in keeping that political advantage, leaders will be willing to sacrifice or bypass democratic processes in order to adhere to a donor's preconditions or preferences in the short-term.<sup>25</sup> However, these leaders are likely to deviate from donor preferences in the long run, in favor of sustaining political advantage in other ways.

In the case of Jordan, I argue that leaders must walk a political "tightrope" between a donor's preferences and the preferences of the governmental leader's selectorate. One can expect Jordanian political leaders to sometimes work in conjunction with donor preferences, but their decisions may possibly shift against donor preferences at a later point if another position is more politically viable.

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<sup>24</sup> Bruce Bueno de Mesquita, Alastair Smith, Randolph M. Siverson, and James D. Morrow. *The Logic of Political Survival*. Cambridge (MA): MIT Press (2003), pp. 10

<sup>25</sup> Barak Hoffman. "Handouts or Handcuffs: The Political Impact of Foreign Aid," (2004), unpublished manuscript.  
Available: <http://socsci2.ucsd.edu/~aronatas/scrretreat/Hoffman.Barak.doc>.

## **Chapter 2**

### ***U.S. Foreign Assistance to Jordan in Institutional Perspective: Agency and the Deconstruction of Actor Preferences***

Is the Millennium Challenge Corporation's novel method of aid distribution better at giving developing countries a tangible push towards incentivizing good governance reform? Before tackling this question, the sheer diversity of the actors within and outside the MCC must be considered, which demands a structured analysis. The current

literature can be grouped in three main categories: 1) assessments by aid agencies on their own country programs, 2) political science literature that focuses on the effects of aid on domestic institutional reform, and 3) game-theoretic research on the interactions between donors and recipients with an emphasis on reducing the likelihood of moral hazard in aid giving.<sup>26</sup> The exploration of the transactions involved in aid-giving within this third section of the aid literature inspired a small, fledgling offshoot literature that utilizes Principal-Agent theory to conceptualize the distribution of aid.

This paper's exploration of the MCC's efforts in Jordan largely relies on the use of this Principal-Agent lens because it allows a deeper, more structured look at the institutional incentives embedded in the relations between each level of the aid delegation chain. The Principal-Agent approach also merges the dichotomy between macro-level decision-making and the local implementation of most aid programs into one coherent analysis. As stated in the introduction, this theory chapter provides the reader with the tools to follow the analysis of the aid transactions from the MCC to Jordan, with the intent of ascertaining the validity and strength of the MCC incentive effect. In the first section, I provide an overview of the institutional dynamics of aid through Principal Agent theory, which is relevant for all aid actors. I then shift my focus to the organizational intricacies of the donor within that same framework. This prepares for the following chapter, which deconstructs the actor (i.e., the MCC) in order to determine what factors and preferences dictate country selection. Consequently, the third section focuses on the aspects of the Principal-Agent Model that deal with the behavior of the agent (i.e., recipient governments). Here I also introduce external theories of the rentier-

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<sup>26</sup> This breakdown on the existing literature on foreign aid is borrowed, in part, from Bertin Martens. Introduction. *The Institutional Economics of Foreign Aid*. Cambridge (UK): Cambridge University Press (2002), p. 5.

state and the selectorate which both attempt to deconstruct recipient behavior and preferences of domestic political actors in policymaking and serve to supplement the overarching Principal-Agent framework used throughout the paper. Finally, I argue that these theories, when they work in conjunction with one another in a seamless framework, adequately deconstruct the aid process and can efficiently provide the criteria for evaluating the MCC incentive effect in its recipient countries.

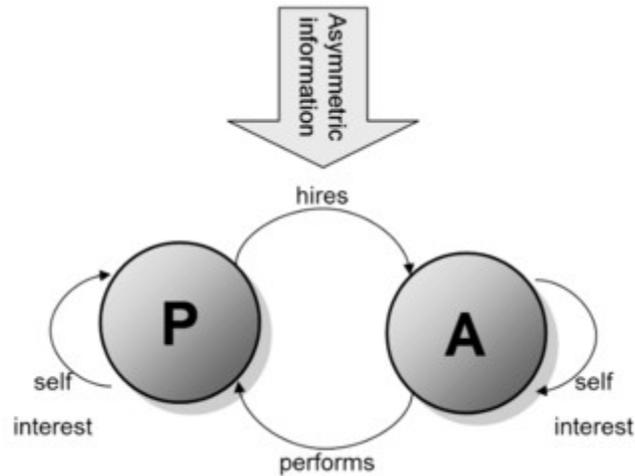
### ***Principal-Agent Theory and Aid: Operationalizing Variables***

Principal-Agent theory is based on the simple observation that hierarchy is manifest in most organizations in some fashion, ranging from the basic business firm to more complex actors such as the United Nations or the Millennium Challenge Corporation.<sup>27</sup> This hierarchy stems from the fact that the decision-makers in these organizations cannot carry out all tasks alone and therefore must delegate to some agent to complete tasks for them. As there is often a dichotomy in the motivations of principals and agents, and because full oversight (ensuring perfect symmetry of information between principal and agent) is either impossible or inefficient, the task is not performed precisely to the principal's preferences. However, by providing incentives to the agent to provide more information and to act in a manner matching the wishes of the principal, such deviance in recipient actions can be controlled. The basic principal-agent relationship is modeled in Figure 2.1 (below).

### **Figure 2.1: Basic Two-Actor Principal-Agent Model**

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<sup>27</sup> This paper does not seek to rehash the history of institutional economics or Principal Agent theory. However, landmark studies such as Coase (1937) and Williamson (1985), or general guidebooks to Principal Agent theory such as Masten and Williamson (1999) surely can give readers an adequate framework with which to understand the theoretical foundations of this theory chapter.



When analyzing the aid disbursement process, however, there is often a multiplicity of actors in the aid delegation chain. This makes the process of following the principal-agent schematic cumbersome. Aid allocation has the added problem that “the people for whose benefit aid agencies work are not the same as those from whom their revenues are obtained: they actually live in different countries and different political constituencies.”<sup>28</sup> The one-directional nature of the aid hierarchy system implicates a huge disconnect between one end of the delegation chain and the other. There is little feedback from recipients about how aid is working, and there is much difficulty achieving adequate oversight on the part of donors (meaning more agency slack allowed to recipients). For instance, in the case of the United States Agency for International Development (USAID), the chain of delegation begins in the United States as Congress approves a budget for a USAID country program as part as USAID’s total program budget. In Jordan, USAID delegates the task of disbursement to USAID Jordan, who then works with the Jordanian government in establishing approved programs that can fall within the budget. About half of these development funds are utilized directly by USAID Jordan, while the other half are controlled by the Jordanian government in support of its

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<sup>28</sup> Martens, p.14

own development plan.<sup>29</sup> After USAID and the Jordanian government reach an agreement, both act as implementers (principals) and hire agents (subcontractors, NGOs) through a complex process of bidding. Thus, each chain of delegation implicates some transference of the embedded “principal-agent” relationship structure. Figure 2 highlights this complex web of delegation as it pertains to USAID’s involvement in Jordan.

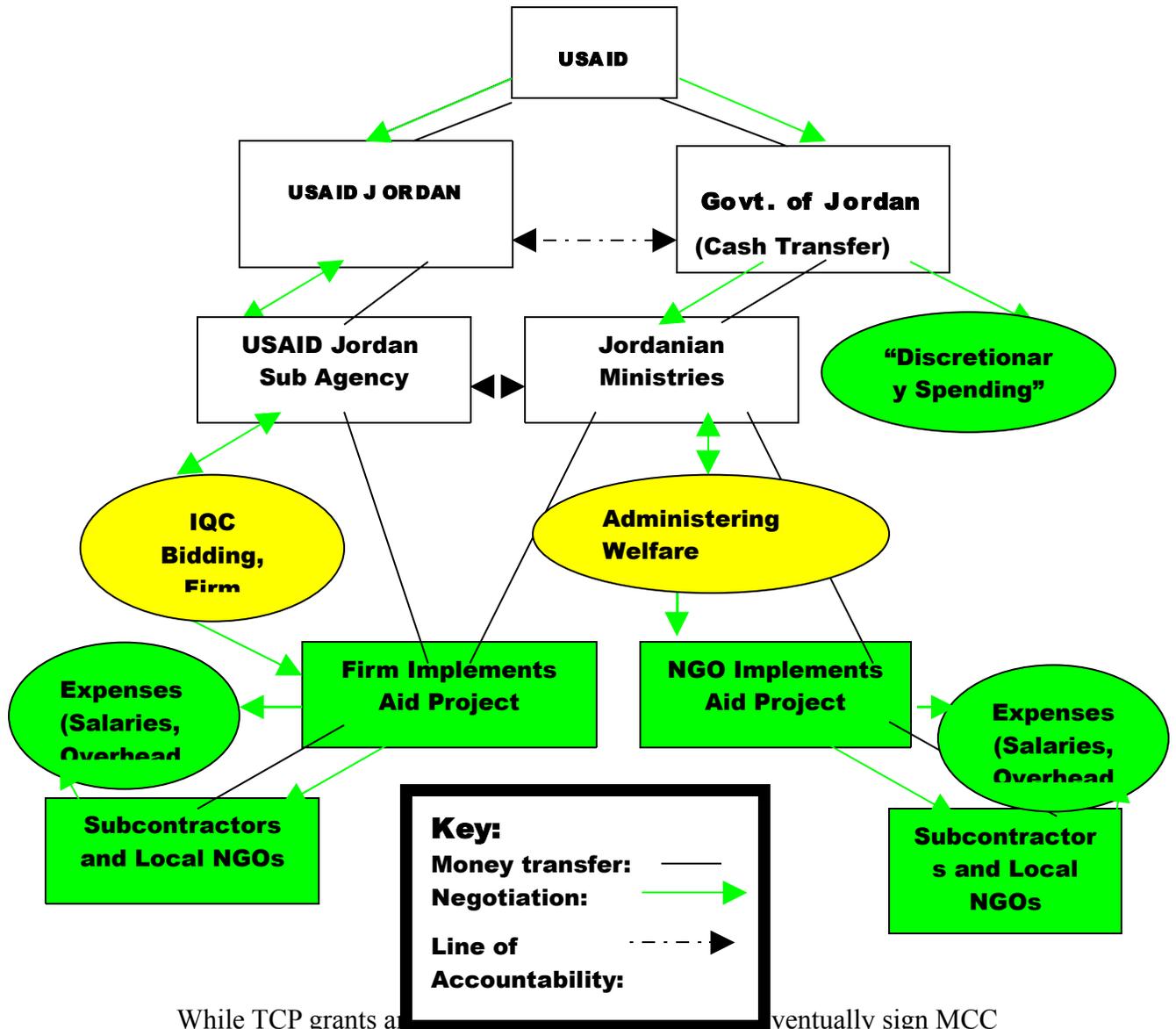
There is a key difference between the USAID/TCP concepts of aid allocation and that of the MCC compact grant: once a country qualifies for an MCC compact and provides a satisfactory compact proposal, *the MCC allows almost complete ownership of grant money and programming that stems from such grant money.*<sup>30</sup> This is a marked departure from all other principal-agent relationships where the intended principal remains the donor, and the recipient may redirect aid *against* the wishes of the donor. In the case of MCC compacts, the donor encourages recipients to use aid as they wish, but only after recipients pass a litmus test of good behavior. The ex post conditionality mechanism of the MCC, once achieved, serves a justification for this transfer of money and power from one principal to another. Another way to look at this same phenomenon is to interpret the use of indicators as “pre-aid oversight,” hoping that enforcing a history of good behavior will endure well past the time of aid distribution. This end result is much more desirable for recipient countries who wish to have more liberty in using funds for their own purposes, and makes an already large prospect of an incentive effect stronger.

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<sup>29</sup> This is not necessarily the case for all USAID recipient countries. Jordan, along with a select few other nations, engages in a “cash transfer” program that is part of the United States’ strategic funding. Clearly, the nature of this funding can affect the nature of the principal-agent mechanism. Future sections of this paper will highlight this fact, but further research into the degree of fungibility and accountability of this fund is necessary.

<sup>30</sup> Many thanks to Brad Parks of the Millennium Challenge Corporation for his clarification of this important facet of Millennium Challenge Corporation’s disbursement strategy.

Figure 2.2: The Path of US Aid to Jordan via USAID (MCC Threshold Grant)



While TCP grants are eventually sign MCC compacts, TCP grants can be seen as an additional litmus test for recipient countries. According to Bradley Parks, a Development Policy Officer at the Millennium Challenge Corporation, if a country fails to implement a TCP grant successfully, its chances for signing a full MCC compact are very slim. *Therefore, the performance on the MCC's seventeen selection indicators, coupled with the full implementation of a TCP (where*

*applicable), can be seen as two main indicators of the strength of a potential incentive effect for good governance/good behavior on the part of a recipient country.* This paper uses the selection indicators, TCP grant, and anecdotal and visual evidence to determine the validity of the MCC incentive effect.

With the framework of the MCC aid distribution mechanisms clear, this paper now deconstructs the actors in the aid process—the MCC and recipient governments—to determine if actors behave in certain ways to reinforce or undermine the MCC incentive effect.

### ***Principal Agent Theory and the Donor: the Implications of Multiple Preferences within the MCC***

The Millennium Challenge Corporation, like many other aid agencies, is dictated by a number of different decision-makers with varying preferences. In turn, these leaders take their cues from a variety of sources, including the U.S. Department of State, Treasury, Congress, and non-governmental actors such as the International Republican Institute.<sup>31</sup> Naturally, there is considerable difficulty in pooling these varying preferences into a uniform decision about country selection and the consequent allocation of funds. This phenomenon is known in the Principal-Agent literature as a “collective principal”. In this situation, actors must reach an agreement amongst themselves before negotiating a contract with an agent.<sup>32</sup>

In private organizations such as businesses, the problems of a collective principal are minimal because all actors (shareholders) share the same objective—profit.<sup>33</sup> In the

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<sup>31</sup> These particular actors will be discussed in detail in the next chapter.

<sup>32</sup> Daniel Nielson and Michael J. Tierney. “Delegation to International Organizations: Agency Theory and World Bank Environmental Reform,” *International Organization* 57 (Spring 2003), p. 247.

<sup>33</sup> Martens, p. 12.

context of the MCC, however, one can realistically expect that the preferences of the State Department are quite different from the International Republican Institute, although they may all fall under the same vague umbrella objective of “economic growth through poverty reduction” as is stated in the MCC mandate. One implication of divergent preferences within a single collective principal, as illuminated by Daniel Nielsen and Michael Tierney, is that “agents may be able to play members of the collective principal against each other,”<sup>34</sup> an implication that proves very informative in the case of Jordan in latter chapters of this thesis.

One other important function of the donor is the level of oversight in determining 1) whether to give aid at all, and 2) once aid is given, whether it is used in the manner delineated by the principal. As discussed before, the former question is one of huge importance for the MCC, and is dependent upon near-perfect information symmetry as relayed by the seventeen governance indicators. The latter question is integral in the case of an existing Threshold Country Plan grant, assuming that the TCP is meant to serve as a litmus test for an eventual MCC compact.

The MCC’s issue whether to give aid at all is dependent upon the selection indicators, and as such, the manner in which they are obtained is important. Unlike many other aid agencies criticized for not being objective and transparent with country selection criteria, the MCC uses sources for indicators independent from the organization (such as the World Bank, Heritage Foundation, and Freedom House). The pertinent question, therefore, is: how much weight is put on selection indicators versus other

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<sup>34</sup> Nielson and Tierney, pp. 249.

factors of selection?<sup>35</sup> A corollary to this question could also be: how accurate are these selection indicators in determining good governance?

When a TCP grant is used as a litmus test for an eventual MCC compact, oversight mechanisms play a much larger role. Oversight is often difficult because of the sheer distance between donor and recipient. In this situation, agents will be more likely to listen to the principal that is most proximate to its activities and exercises the most extensive oversight mechanisms. To this end, in enforcing preferences for a TCP grant, the MCC can engage in “police-patrol” oversight in which the MCC directly oversees and enforces behavior, or “fire-alarm” oversight in which the MCC relies on external oversight mechanisms (through delegation or other methods). Analogous to the use of real police patrols, police-patrol oversight is direct and centralized, whereas fire-alarm oversight is indirect way of oversight that involves less direct involvement and intervention.<sup>36</sup> While both police-patrol and fire-alarm oversights are available means of oversight to the MCC, the MCC by necessity must rely on the latter for much of its surveillance. Although it is often less stringent, fire-alarm oversight is more efficient and plausible for small organizations like the MCC.<sup>37</sup>

### ***Deconstructing the Agent: Principal Agent Theory, Rentierism, and Domestic***

#### ***Behavior***

As donors want to maximize their return on their “aid investment” and therefore minimize the amount of recipient agency slack, inefficiency, and deviance, so too do

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<sup>35</sup> As stated in the introductory chapter, other factors include “the opportunity to reduce poverty and generate economic growth within a country.”

<sup>36</sup> For a good overview of police-patrol vs. fire-alarm oversight in the context of Principal-Agent Theory, see Mathew D. McCubbins and Thomas Schwartz. “Congressional Oversight Overlooked: Police Patrols versus Fire Alarms,” *American Journal of Political Science*, 28:1 (Feb. 1984), pp. 165-179.

<sup>37</sup> The Millennium Challenge Corporation has a very small bureaucracy (between 200-300 members) all in Washington, D.C. Therefore, much of their overseas enforcement must come through third parties.

recipients desire to maximize the amount of funding directed towards their own goals. If principals and agents are able to come to a true consensus over preferences and goals, however, recipients are less likely to attempt to defy donor oversight mechanisms. If the MCC and recipient governments have the same objectives in fomenting good governance reform, both will look to improve their selection indicators and will encourage the successful implementation a TCP grant. However, if there are preferences in a recipient government that diverge from the donor preference, recipient adherence to donor preferences will diminish. Two results are possible: 1) a game of deception between donor and recipient where recipients pretend to adhere to donor wishes but actually don't (i.e. the artificial improvement, rather than real improvement of selection indicators for the MCC), or 2) a tightrope walk on the part of the recipient to equally adhere to a donors wishes (because of the necessity of aid for its constituents) in addition to other objectives.

As full adherence to donor preferences is rare and not realistic given the collective nature of most recipient populations and governments, an exploration of these two possible examples in theoretical perspective can help illuminate the dynamics of recipient behavior more fully.

#### *The Concept of Rent-Seeking in Explaining Recipient Behavior*

In order to illuminate the underlying causes of the variation in recipient government behavior, an exploration of rent-seeking behavior is necessary. Agents may be forced to walk a tightrope between donor preferences and their own needs, but the incentive of prospective aid funds may shape recipient behavior as much, if not more, than domestic determinants. However, rent-seeking is economically inefficient because

actors no longer act in a positive-sum game. To reveal the dynamics of rent-seeking, an independent example is most illustrative.<sup>38</sup>

Consider a U.S. Government program that awards grants to countries to improve democratic governance (not so different from the MCC). Suppose that this program provides the possibility of a \$40 million dollar grant, but only a select few are able to attain the grant through an open competition (bidding). If one out of ten countries who apply receive this award, and each of these countries spend an average of \$2 million dollars altering indicators, preparing proposals, and hiring experts to aid in the bidding process, the end result is one transfer of \$40 million and the expenditure of \$20 million in resources over ten countries. This is a negative-sum game.

In reality, recipients of large levels of aid over lengthy periods of time may become dependent on aid packages as an input into the country's budget, and regimes often can alter their domestic or foreign policy decisions in hopes of receiving more aid. When a recipient government is dependent upon one particular input (aid) for much of its revenue and therefore shapes its policy upon the short-term maximization of that input, this detracts from the usual "profit-seeking" behavior seen in functioning markets. While in an idealized world, aid would create synergies between existing policy and new policies set up by aid programs, in reality, policy resulting from aid-seeking behavior can be detrimental to the country's democratic or economic development and is often characteristic of authoritarian rule.<sup>39</sup>

There have been two main speculations about the effect of aid dependence (which we will identify with rent-seeking behavior). First, incumbent governments will use aid to

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<sup>38</sup> Anne O. Krueger. "The Political Economy of the Rent-Seeking Society." *American Economic Review* 64:3 (1974), p. 291.

<sup>39</sup> Bruce Bueno de Mesquita, Alastair Smith, Randolph M. Siverson, and James D. Morrow. *The Logic of Political Survival*. Cambridge (MA): MIT Press (2003), pp. 10.

sustain their political advantage (if such an advantage is threatened).<sup>40</sup> Second, leaders are willing to sacrifice or bypass democratic processes in order to adhere to a donor's preconditions or preferences in the short-term.<sup>41</sup> However, these leaders are likely to deviate from donor preferences in the long run, in favor of sustaining political advantage in other ways. In many cases, this political "tightrope walk" involves the accountability of a leader to his or her *selectorate*, or the people in a given country that have an institutionally granted right or norm that gives them a say in choosing leaders, influencing policy, and removing leaders from power.<sup>42</sup> Often this involves elites, coalitions in government, influential social groups, and interest groups, among others. The selectorate often have their interests best represented in government, as they ensure that the status quo regime has adequate support. This political "tightrope walk" will sometimes work in conjunction with donor preferences, but may often shift against those same preferences at a later point if another position is more politically viable.

In the case of the MCC, the political behavior of an actor in adhering to MCC preferences (of selection indicators and of full implementation of a TCP grant) is intrinsically tied to the extent to which a political regime feels that aid is necessary when weighed against other factors. Therefore, ex post incentives to adhere to MCC criteria must outweigh disincentives in favor of more politically viable alternatives. A third option exists as well: if a country is desperate for aid, but cannot realistically achieve the change required of the MCC in the face of domestic pressure, potential recipients may

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<sup>40</sup> Bruce Bueno de Mesquita, Alastair Smith, Randolph M. Siverson, and James D. Morrow. *The Logic of Political Survival*. Cambridge (MA): MIT Press (2003), pp. 10.

<sup>41</sup> Barak Hoffman. "Handouts or Handcuffs: The Political Impact of Foreign Aid," (2004), unpublished manuscript.

Available: <http://socsci2.ucsd.edu/~aronatas/scrretreat/Hoffman.Barak.doc>.

<sup>42</sup> This definition borrows heavily from Bruce Bueno de Mesquita, James D. Morrow, Alastair Smith, and Randolph M. Siverson's "Political Institutions, Policy Choice, and the Survival of Political Leaders." *British Journal of Political Science*, 32:4 (2002), pp.560.

attempt to artificially improve indicators or deceive donors into believing that real change occurs.

### ***Conclusion***

Within this examination of a possible MCC incentive effect, this chapter defines the key actors both at the MCC and in recipient countries within the context of Principal-Agent theory. Through examining the tenuous relationship between the MCC and its recipients, we see that two factors measure the strength of the incentive effect for good governance/good behavior: 1) a recipient's performance on the MCC's seventeen selection indicators, plus; 2) the level of implementation of a TCP grant. However, this effect may diminish if the donor's preferences stray from using the MCC indicators as the main basis for disbursement of funds, or if the indicators themselves are not adequate measures of good governance behavior. This includes the TCP "litmus test" of good allocation: if the oversight mechanisms over the TCP grant are inadequate, the effect may not be interpreted properly.

On the recipient side, there are many intervening factors that may force recipients to stray from MCC preferences and cause the incentive effect to diminish. Recipients may have to walk a tightrope between the preferences of the MCC and the demands of its selectorate and other domestic determinants of policy. If this tightrope-walk is unsuccessful, but aid is still necessary, potential recipient countries may attempt to deceive their donors in a variety of ways.

This paper uses the selection indicators and TCP grant, plus anecdotal and visual evidence to determine the efficacy of the MCC incentive effect, and its strength in the

face of competing domestic factors. Using the case study of Jordan as a foundation for understanding these dynamics between principals and agents in the MCC delegation chain, the following chapters aim to uncover some of the unanswered questions about the success of MCC programs in recipient countries.

## **Part II: Data and Interviews**

Over the past fifty years, the literature on economic and political development had exhibited an ebb and flow of new theories and responses to these theories. Much has been discovered about the overall themes of development, capital accumulation and savings,

and democratic governance and participation. However, objective academic studies have fallen short of providing a clear picture of the dynamics of aid transactions for recipients and donors. As mentioned in the first chapter of this thesis, aggregate studies of aid allocation may present prevailing trends of behavior, but do not offer nuanced explanations of why such trends occur. This section deconstructs the strategic decisions of the Millennium Challenge Corporation and the Jordanian Government using an observational approach not employed by most academics writing on aid allocation: interviewing. I believe that we can learn much about the truly complex forces at work by watching, listening, and talking to actors in the aid process as they make decisions about potential aid funding, thus interpreting aid allocation not only by statistical figures, but by observing the world as the implementers do. Furthermore, observations from interviews reinforce and highlight what statistics express in a more specific manner.

## *Chapter 3*

### *The Millennium Challenge Corporation as a Strategic Actor: The Board of Directors*

*Part I: The Path of Aid—The Donor*

#### *The Millennium Challenge Corporation as a Strategic Actor: The Board of Directors*

In Chapter 2, I discussed how the framework of Principal-Agent theory allows analysis of the relationships between individual actors and also illuminates the specific dynamics within the Millennium Challenge Corporation. The Millennium Challenge Corporation's main decision-making body is its Board of Directors, which is comprised of four lead government officials (Secretary of State, Secretary of Treasury, U.S. Trade Representative, and USAID Administrator) and four public members (experts from NGOs and private firms). Thus, the Board of Directors is a “collective principal” who

must negotiate internally conflicting agendas while allocating MCC funds. This entails making difficult individual decisions regarding country selection and the disbursement of funds while adhering to the MCC's standards are judged by the seventeen good governance indicators.

Since the subset of countries the Board of Directors has to choose from is dictated by an evaluation of the recipient's performance using the seventeen indicators, it is important to understand how accurately the MCC can assess a given country's performance. Although MCC officials travel to recipient countries on occasion, they rely heavily upon the judgment of the independent organizations they have charged with measuring and sharing indicator information. Therefore, the MCC's manner of oversight is dependent upon the accuracy of information provided by these independent organizations. Overall, the findings in this section suggest that the oversight mechanisms afforded to the MCC by independent organizations such as the World Bank and Freedom House are comprehensive and accurate.

However, the bulk of this chapter explores another pertinent question in the MCC's decision-making process: when evaluating a country's performance, how much weight is put on the indicators as assessed by independent organizations versus other determinants of aid disbursement? In truth, nearly every governmental member of the Board of Directors serves a "double-hatted" role: although they serve as leaders of the MCC, they have a significant mandate from another government agency that may or may not be at odds with the pure objectives of the MCC. This "double-hattedness" is no accident: since the four governmental members all fall under the broad umbrella of the U.S. Government bureaucracy and are all beholden to the President of the United States,

they systematically incorporate their priorities from one bureaucracy into their preferences of another. Conversely, the four public members are not subject to the same dual role of the governmental members; however, these members are heavily reliant upon their expertise, which was cultivated in their home organizations.

Therefore, this chapter will first briefly look at the manner through which the MCC conducts its oversight on recipient countries and the unique role that independent organizations play in measuring the indicators of good governance. Then, in order to understand the unique perspectives of the MCC Board of Directors members, I will provide some background on each of the eight permanent members of the Board and the corresponding bureaucracies to which they each belong. Finally, using interviews that range from key advisors to MCC Board members and MCC officials, I examine how these members' preferences often manifest themselves in the strategic decision-making processes regarding country selection and disbursement of funds. These strategic decisions play an integral role in whether the MCC incentive effect is manifested in its recipient governments. If it is determined that MCC Board members are both willing and able to hold countries accountable for actions before aid is even sent, then it is much more likely that we observe the incentive effect.

### ***Independent Organizations and the Oversight Mechanisms of the MCC***

The MCC's limited bureaucracy of three-hundred makes it difficult for the organization to have the capacity to make the on-the-ground observations required to hold countries accountable for the required levels of good governance indicators. Thus, early in its conception, the MCC charged independent organizations proven in the field of

International Development and aid with providing them with accurate and detailed analyses on country performance as well as ascertaining a score on the indicators. This is best illustrated with an example, such as Freedom House’s task of holding potential recipients accountable for the MCC indicator of “Political Rights.”

*Freedom House and the “Political Rights” Indicator*

According to the MCC document “Guide to the MCC Indicators and the Selection Process,” the Political Rights indicator measures country performance on the “quality of the electoral process, political pluralism and participation, government corruption and transparency (although there is a separate measure for corruption as well), and fair political treatment of ethnic groups.”<sup>43</sup>

Specifically, Freedom House identifies and rates countries on the following proxies for political rights:

- Free and fair legislative and executive elections; fair polling; honest tabulation of ballots;
- Fair electoral laws; equal campaigning opportunities;
- The right to organize in different political parties and political groupings; the openness of the political system to the rise and fall of competing political parties and groupings;
- The existence of a significant opposition vote; the existence of de facto opposition power, and a realistic possibility for the opposition to increase its support or gain power through elections;

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<sup>43</sup> MCC’s “Guide to the MCC Indicators and the Selection Process.” Available at: <http://www.mcc.gov/documents/mcc-fy08-guidetoindicatorsandtheselectionprocess.pdf>

- Self-determination, self-government, autonomy, and the participation of minority groups through informal consensus during the decision-making process;
- Freedom from domination from the military, foreign powers, totalitarian parties, religious hierarchies, economic oligarchies, or any other powerful group in making political choices;
- The openness, transparency, and accountability of the government to its constituents between elections; freedom from pervasive government corruption; government policies that reflect the will of the people;
- The extent to which a government deliberately changes the country's ethnic composition to affect the political balance of power.

Freedom House recognizes that measuring a concept as complex as political rights is not an easy task, but realizes that the ramifications of a country's performance in this indicator is far reaching when trying to foment economic growth and poverty reduction. If a country's institutions are not stable, these goals are much more in flux. As such, they use the expertise of independent experts to evaluate countries on a 40-point scale (with 40 representing "most free" and 0 representing "not free"). In the context of Jordan, freedom house currently scores them as "Partly Free".

*Does Freedom House Constitute an Independent Organization?*

Freedom House asserts itself as a Non-Governmental Organization free from direct influence by U.S. government employees or preferences. In the past, however, the organization has received criticism doubting its independence. Indeed, the organization

receives most of its funding from the U.S. Government<sup>44</sup> and has former and current U.S. government officials serving on its board as advisors.

Nevertheless, Freedom House has been very critical of the MCC as it pertains to its disbursement policy and country selection.<sup>45</sup> As an independent organization whose top priority is to ensure that the MCC takes its recommendations seriously, it has published recommendations against the MCC's selection of countries that do not pass its indicator on Political Rights. Moreover, Freedom House has suggested on more than one occasion that the Political Rights indicator should be treated as a "requirement indicator" much like corruption, and not on the same levels as other measures of good governance. The MCC has recognized the importance of the Political Rights indicator, but has not taken steps to make it a "requirement indicator," much to the chagrin of the Freedom House administration.

### *The Dynamics of Oversight*

If we take the manner in which Freedom House assesses and attempts to hold countries accountable as valid and effective, the question then becomes: "How much weight does the MCC place on the recommendations and findings of Freedom House." As mentioned in Chapter 2, the MCC must rely heavily on independent organizations to exhibit what is known as "fire-alarm oversight." This places an extra step in the oversight process: organizations like Freedom House must report back to the MCC in a timely fashion, and the MCC must choose to interpret the oversight and enforce better behavior.

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<sup>44</sup> See [www.freedomhouse.org](http://www.freedomhouse.org) for more information on its funding.

<sup>45</sup> Freedom House Press Release: "Millennium Challenge: Funds should go to States Committed to Democracy." November 2, 2005. Available at: <http://www.freedomhouse.org/template.cfm?page=70&release=307>

In terms of the Political Rights indicator and a number of other indicators, Freedom House serves as the eyes and ears of the MCC on the ground as “fire-alarm” overseers. As mentioned in Chapter 2, fire-alarm oversight is the type of oversight suited best for the MCC because of the MCC’s small bureaucracy, but has some drawbacks. For instance, fire-alarm oversight is indirect, which decreases the strength of credible oversight: Freedom House has no real power to suspend funding or otherwise punish a recipient country. Rather, they must report a violation or deficient indicator to the MCC, and the MCC must then choose how to react to this indirect report of a violation.

It is important, therefore, to understand what role the advice that independent organizations give through reports and indicator scores plays in the Board of Directors decision-making process. Freedom House, in this respect, attempts to hold the MCC accountable to its own stated commitment to good governance through publishing public reports on a country’s indicator performance as well as making public assessments of MCC decisions. However, these reports come on a yearly basis (save for special reports); therefore, the frequency of reporting and (perhaps) the stringency of oversight is diminished somewhat. If recipients perceive oversight to be weak, the donors have much less credibility and recipient deviance from donor preferences is much more likely.

### ***The Millennium Challenge Corporation’s Board of Directors: a Collective Principal***

Figure 3.1 shows the main actors on the MCC Board of Visitors, including four government officials and four non-government members and their main advisors in addition to MCC CEO Ambassador Danilovich. Here, it is important to recognize the different organizations represented and the potential bureaucracies for which they work.<sup>46</sup>

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<sup>46</sup> Added at the end of the document for this paper.

What follows therefore, is a description of their offices, the capacity in which they serve the MCC, and the perspectives they bring to the position that can dictate their approach and preferences.<sup>47</sup>

#### *Condoleezza Rice and the U.S. State Department*

On the MCC Board of Directors, Secretary of State Condoleezza Rice serves as Chair and is therefore the moderator during all official meetings on the Board. She therefore can dictate agenda more than any other member of the Board in addition to serving as a full voting member. As mentioned earlier, these governmental Board members when serving at the MCC are double-hatted, and this has none greater implication that with Secretary Rice. The U.S. State Department is a huge and powerful bureaucracy in the U.S. Government charged with executing the foreign policy decisions of a given administration, and Secretary Rice incorporates U.S. positions on foreign affairs in many votes on compacts.

#### *Henry Paulson, Jr. and the Department of the Treasury*

Secretary of the Treasury Henry Paulson serves as Vice-Chair of the Board of Directors, and is a key player in determining the allocation of funds by the MCC (in addition to any of the U.S. Government's financial endeavors). Paulson, along with other experts from the Department of the Treasury provide expertise on how the MCC's plans fall within the mandate of the Treasury to promote economic growth and stability both to recipients, and they are also chiefly concerned with the manner in which these funds

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<sup>47</sup> In respect to the preferences, these descriptions reflect, in large part, the first-hand interviews with direct advisors to MCC Board members. Their names are omitted by their request.

promotes the financial well-being of the United States. Notably, Paulson himself rarely attends the MCC Board of Directors meetings, thus giving his main advisors more responsibility in executing their collective decisions.

*Susan C. Schwab and the U.S Trade Representative*

U.S. Trade Representative Susan Schwab is the United States Trade Representative as appointed by Congress, and serves on President Bush's cabinet as his principal trade advisor, negotiator, and spokesperson on trade issues. As such, her capacity on the MCC Board is to ensure that the MCC be cognizant of the United State's key trading partners and to advise on potential regions of improvement. As the MCC looks to improve potential recipients' performance in Customs administration and foreign access to markets, the office of the USTR seeks to ensure that the MCC serves as a capacity-builder to our current and potential trading partners.

*Henrietta Fore and the United States Agency for International Development (USAID)*

As head of USAID, Fore acts as the lead liaison between the two organizations and is charged with making sure they act as complements of one another. She is Acting Director of U.S. Foreign Assistance, and in essence serves as the head decision maker from either the MCC or USAID. Ms. Fore is particularly embedded with the MCC Threshold Program, as the USAID country teams are the main implementers of these grants. As such, she has a responsibility to incorporate new MCC initiatives with existing USAID initiatives to make the allocation process as efficient as possible.

*John Danilovich and the MCC Bureaucracy*

Danilovich serves as the MCC Chief Executive Officer, and as such, is the head of the MCC bureaucracy. On the board, he is charged to represent the interests of the MCC in disbursement of funds, country selection, and relations with other governmental actors. Often, this involves garnering the expertise and support from other governmental sectors, and to place emphasis and support for the novel method of MCC allocation and the good effects that has come from its involvement in developing countries. Furthermore, he is the main spokesperson for the MCC in the media and public events, holding public outreach sessions and events multiple times per month.

*Lorne Craner and the International Republican Institute (IRI)*

Lorne Craner is the President of the IRI, a non-profit organization whose mission is to promote international political progress through open elections, civic institutions, good governance, and rule of law.<sup>48</sup> Their Board of Directors is largely acknowledged in public circles to be right-winged, as many on the IRI Board of Directors are Republican government employees and its Chairman is Senator John McCain. Furthermore, the IRI gets much of its funding from both the U.S. Government and the National Endowment for Democracy (NED), whose website acknowledges past ties with the U.S. Central Intelligence Agency. There also has been some question to the function of the IRI in international development because of their controversial support of right-wing political parties interfering in foreign regimes, particularly in Haiti and Poland. However, IRI maintains that it is a non-partisan, non-governmental organization.

Craner is one of the four public members of the MCC Board, and as such, is mainly charged to provide expertise on MCC operations from the point of view of a

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<sup>48</sup> From ISI website, available at <http://www.iri.org/>

development professional. He has also served in a leadership capacity on the MCC Audit Committee.

*Former Senator Bill Frist*

Frist, a former Senate Majority leader for the Republican Party from 2002-2007, was the replacement for Christie Todd Whitman on the MCC Board of Directors. Frist brings little expertise from an international development standpoint besides participating in medical humanitarian work in Africa, but is much more likely to play a role in garnering support for the MCC in Congress. In a statement from Senate Republican Leader Mitch McConnell after Frist's confirmation on the MCC Board, he reflected that Frist would assist the MCC in "creating clear cut objectives that aid developing nations and support an overall U.S. Foreign Policy."<sup>49</sup>

*Ken Hackett and Catholic Relief Services*

Ken Hackett serves as the president of Catholic Relief Services, the international humanitarian agency of the U.S. Catholic community. Although it is a Catholic Organization, its work is purposefully not "missionary" in nature, but rather has an emphasis on sustainable, community-based development initiatives. Unlike the MCC, the CRS bases nearly all of its efforts on the need of a recipient. The CRS is a proven leader in this regard, and as such, Hackett's role is to make known the NGO experiences and concerns in development on the MCC Board of Directors. His involvement and

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<sup>49</sup> Article available online at [http://www.politico.com/blogs/thecript/1007/Frist\\_confirmed\\_to\\_antipoverty\\_post.html](http://www.politico.com/blogs/thecript/1007/Frist_confirmed_to_antipoverty_post.html)

dedication to his position on the Board has been praised as exemplary, resulting in the renewing of his term on the MCC Board in 2007.

*Alan J. Patricof and Greycroft LLC*

Alan Patricof was approved to the MCC Board in 2007, and comes from a highly successful background in venture capitalism with Greycroft, LLC. He has played an integral role in the global promotion of such companies as American Online, Office Depot, and Apple Computer, among others. His experience has largely been with for-profit firms with high net-worth investors, and the MCC may use this expertise in calculating whether current and future compacts are likely to be successful “investments.” His expertise is also valuable from a private investment standpoint, as the MCC indicators include trade policy, business start up, and regulatory quality.

***The Strategic Decision-Making Processes of the Millennium Challenge Corporation:  
First-Hand Accounts***

I hypothesize that the distinct backgrounds of individual Board members at the MCC not only shape the decisions that are made, but the manner in which Board members reach these decisions as well. As such, the following section explores a set of first-hand interviews that discuss how the backgrounds of Board members interact with each other.<sup>50</sup> Specifically, I divide the analysis into two categories. The first set of observations deal with the implications of hierarchy and inner politics on the MCC Board as manifested both at general board meetings and behind the scenes before the Board

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<sup>50</sup> Because of the sensitive nature of much of this content, I have agreed to be nondescript about the specific names of those I have interviewed. I am able to say that all excerpts came between 2007 and 2008, conducted with direct advisors to members of the MCC Board of Directors as well as Officers at the Millennium Challenge Corporation in Washington.

even meets. Second, I look at how heavy the aforementioned backgrounds and preferences of individual Board members weigh in the final decision-making process, especially in comparison to the MCC's rules (that potential recipients must meet the given level of good governance as measured by the seventeen independent indicators).

*MCC Board of Directors: Hierarchy and Behind-the-Scenes Politics*

As mentioned earlier in the chapter, Secretary of State Condoleezza Rice is the chair of the MCC Board of Directors and has considerable stature as it pertains to setting the MCC Agenda (along with Ambassador Danilovich). As Secretary Rice herself does not deal with the MCC on a full-time basis, she is briefed about both the recent happenings at the MCC typically a few hours before MCC Board of Directors meetings. However, Secretary Rice does deal with official U.S. Foreign Policy on a regular basis, and as such, may be more likely to incorporate her knowledge of U.S. policy towards individual decisions at the MCC, where she has considerable agenda-setting power. Therefore, other members of the board must work considerably harder to exert the kind of influence afforded to Secretary Rice:

If the State Department has a clear opinion about a given country, and a clear notion on how they want to handle country selection or fund disbursement, and you're against it, you had better be coming with guns blazing. You need a great, potent, and succinct argument for your case, and you better have already negotiated with most of the advisors of other Board members.

This kind of "behind-the-scenes" coalition building is common on the MCC Board, especially when contentious issues on country selection are on the table. The State

Department traditionally works closely with both the Department of the Treasury and the U.S. Trade Representative, and their main advisors often work together ahead of time to present a united front for a given decision for country selection or disbursement.

Therefore, the non-governmental members tend to have a disadvantage in the consensus building process, only because they are not part of the U.S. Government umbrella bureaucracy and do not have the same ultimate principal (the President). As such, non-governmental Board members have considerable discretion in considering options that are not directly involved with U.S. interests (such as pushing for a recipient in considerable need of aid), but they face an uphill battle if it is not on the agenda of other members. One advisor to a non-governmental member on the Board commented that there is a tangible divide on the MCC Board of Directors when it comes to behind-the-scenes planning and consensus building:

As a non-governmental member, you don't represent the U.S. Government like the majority of the MCC Board members. Rather, you are representing the expertise of the development community on the Board, which is a different animal from representing the interests of the U.S. Government. Plus, since non-governmental members work in different bureaucracies for different causes, we don't necessarily see eye-to-eye on many issues that Schwab, Paulson, and Rice would usually.

Additionally, not all governmental members are void of U.S. Government influence. As mentioned earlier, two of the non-governmental members of the Board, Frist and Craner, have indirect ties to the U.S. Government. Frist was a former Republican Majority Leader in the Senate and has clear ties to the Republican party and the Administration, and

Craner is the President of the IRI, an organization who receives the majority of its funding from the U.S. Government.

Nevertheless, observers confirm that, in most cases, all Board members place a large amount of emphasis on the seventeen indicators of good governance in their actions. After all, the MCC is a product of the Bush Administration, and their successes reflect well upon the President and his advisors. Therefore, the governmental members do not seek to undermine the MCC's credibility outright by pushing for compacts with countries that clearly do not meet the MCC good governance standards. However, with countries on the threshold between qualifying and not qualifying, the MCC is allowed to use its discretion to award compacts to the countries that exhibit "great potential" to alleviate poverty and promote good governance. Countries interpret this discretion in different ways:

Each member of the Board feels that the strict standards of the MCC are its best asset. The first handful of compacts showed us that the MCC's emphasis on good governance is a good threshold for countries to achieve before being trusted to handle large aid compacts. However, it is also clear that different MCC Board members have different ideas of how to consider "good governance." The indicator requirement is clear: countries must pass nine of seventeen indicators, including the corruption indicator. Beyond that, the MCC Board members consider the *potential* of the MCC to alleviate poverty and promote good governance in a country. For example, the State Department usually weighs this potential as an opportunity to promote good governance in specific partners of the U.S. Government. The USTR weighs the potential of a country in expanding their markets and allowing foreign and U.S. investors to invest easily. The CRS often will push for the countries that are the most impoverished, with the most demonstrated need.

Though this discretion does not apply in all cases, it does allow Board members some leeway in deciding, on the margins, whether a country should or should not be selected. In recent years, the amount of cases that could be classified as “on the margin” has increased significantly.

*Walking the Tightrope: Ambassador Danilovich and the MCC Board of Directors*

For the four non-governmental MCC Board members, they face an uphill battle when the decision-making process takes a turn away from their preferences. However, this job of pooling preferences has the furthest reaching implications for Ambassador Danilovich. As MCC CEO, it is his responsibility to represent the mandate and rules of the MCC’s distribution policy are represented in the decisions of the Board. If the Board drifts too far away from the MCC mandate and disregards the advice of third-party organizations like Freedom House, the MCC loses credibility as an institution. If, on the other hand, the MCC disregards the priorities of the State Department, Treasury, Congress, USTR, and even USAID, they may lose the funding and political backing needed to keep this new Government organization working and achieving its desired ends.

Therefore, Danilovich must walk the “tightrope” of political action in cases where the MCC rules require one outcome but bureaucratic preferences prefer another. This can manifest itself in two ways. First, a country can reach the MCC threshold of good governance, but the U.S. Government may not want to give funds (for political reasons). In this case, the MCC cannot disburse funds according to its own rules if the country is

restricted from receiving U.S. aid by Congressional statute.<sup>51</sup> If they are not on this list, in theory, they are still eligible for MCC funds (though may have considerably more trouble getting approved by MCC Board members). Second, a country may perform questionably or sporadically on MCC performance indicators (and prior grants), but if the U.S. Government is eager to give funding, the MCC must be strong in rejecting the preferences of the U.S. Government. According to one MCC Board advisor, this only happens in some cases:

Usually, these discrepancies between MCC rules and U.S. Government preferences don't pose too much of a problem on the MCC Board of Directors because each of the Board members are in full support of the MCC's method of aid allocation and what they're trying to do. However, in cases on the margin, countries that have competent MCC indicator scores in nine of the seventeen indicators, but show poor records in other indicators or score sporadically on important indicators are interesting cases. This is where the Board can use its discretion in approving or rejecting compacts. In most cases, we send a Threshold Grant to these countries, but sometimes, they may receive compact status.

In such cases where the Board is able to use these discretionary powers, it is important to hypothesize how the Board will strategically act towards such countries "on the margin." Will they hold these countries accountable to a high standard of good governance (as is urged by Freedom House and other independent organizations), or are they more likely to grant a compact? I hypothesize that a recipient's actions, as well as MCC Board preferences, play a key role in this situation.

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<sup>51</sup> The list is usually restricted to countries that have extremely poor human rights records or are officially designated as state sponsors of terror by the State Department.

## ***Conclusion***

The main observations of this chapter are two-fold. First, MCC oversight is clearly indirect most of the time, which is evident in the MCC's use "fire-alarm" oversight mechanisms in coordinating with independent organizations. These oversight mechanisms are subject to the manner and weight the MCC places on reports from organizations like Freedom House, and this has a clear effect on the MCC's credibility. Second, the MCC is a *strategic* donor. The divergent preferences on the Board shape the decisions of the MCC as it pertains to country selection and disbursement. While the MCC places a clear emphasis on its rules and the seventeen indicators of good governance, the MCC Board members are afforded discretion while dealing with potential recipients that are on the margins of receiving funding but are deficient in some key categories. I hypothesize in the next chapters that the MCC uses this discretion subjectively, i.e., *discretion is largely dependent upon the potential recipient's behavior and interaction with the donor*. If the discretion is used cautiously, deferring to the MCC indicators and prioritizing good governance reform, the MCC effect is likely to stay strong. However, if discretion is used such that strategic partners benefit, then the incentive effect may be diminished.

Chapter 5 analyzes and models this particular phenomenon; however, it is important to first understand a recipient's strategic decision-making behavior before this analysis. Thus, the next chapter presents the particular behavior of Jordan within the context of its perception of the MCC's commitment and its own preferences.

## **Chapter 4**

## ***Jordan as a Strategic Recipient: the Short and Long-Term Ramifications of Aid-Seeking***

### ***The path of aid – The Recipient***

The following chapter looks at the decision-making process of the actors in Jordan in seeking aid from the Millennium Challenge Corporation. The interviews, above all, look to observe the plausibility of the MCC incentive effect as measured by the actions of the Jordanian Government and the subsequent reactions of other aid actors in Jordan. How and why did the Jordanian Government decide to seek MCC funds? As the plausibility of an incentive effect was confirmed and Jordan began to seek funds, I then looked to observe which factors in Jordan were detracting or enhancing the ability of the MCC incentive for good governance to take hold.

Furthermore, the questioning in the interviews also sought to ascertain Jordan's attitudes and treatment to past aid flows targeted at good governance reform. In previous chapters, I put emphasis on this type of analysis because I believe that Jordan's

performance on past aid programs targeted to improve good governance (including the 2006 Threshold Country Plan Grant to Jordan) can serve as litmus tests to predict their treatment of future MCC funding. If Jordan gave real credence to the priorities of good governance before, the MCC is more likely to decide that Jordan's commitment to good governance is credible and will be sustained. If this is not the case, however, and the MCC awards funding regardless, we can expect the likelihood of "cheating" on the part of Jordan to increase.

What follows, therefore, is a report compiling the findings of my observations in Jordan on both the aid process in general and the specific interactions of the MCC with Jordanian actors. Between the autumn of 2006 and the summer of 2007, I travelled to Amman, Jordan and interviewed current and former Jordanian government officials, NGOs and contractors, U.S. aid officials stationed in Jordan, and other academics observing the functions of aid in the country. I first met and talked with individuals about their general role in the disbursement process, then tackled more specifically about prominent themes about the decision-making and the motivations behind such decisions. I was able to conduct follow-up interviews via email and phone in late 2007 and 2008, and I was kept abreast of their actions with reports from fellow researchers throughout the whole study. The specific "whos" and "whens" of these interviews in Jordan are expressed in Table 4.1.

When speaking to aid contractors that have been implementing projects in Jordan for an extended amount of time, a recurring theme emerges: implementers believe that the "business of aid" in Jordan is huge, and that the aid community struggles to keep up with all the new initiatives put forth by USAID and the Jordanian Government. The

strategic advisor for a local NGO contracted to implement small projects, Winkie Williamson, reflects on this sentiment:

It may be the case that there might be too much money to go around for aid implementers. Here in Jordan, there are always projects from USAID up for bidding, and even a small NGO (like her Jordanian Hashemite fund for Human Development) can get a piece of the pie. However, I would call the effectiveness of so much aid into question: projects overlap, there is no accountability or project assessment by a credible third-party, and the Jordanian people and institutions don't actually reform in many cases. Perhaps they have the impression that they have an open-ended agreement with the United States as a donor country, and there is less incentive for them to actually reform. They'll get the money either way.<sup>52</sup>

There is a slight sense by those embedded in the Jordanian aid community that there is more money available than are useful projects to implement. Aid transfers from the United States to Jordan since the late 1990s have intensified (see Table 1 at the end of this chapter), especially since the start of the Iraq war in 2003, and this may contribute to this sentiment. One possible explanation for this is that, despite diminished absorptive capacity for aid inflows, the Jordanian government has consistently (and successfully) sought aid from the United States. Since signing the Israeli-Jordan Peace Accords in 1993, the United States has contributed significantly to Jordan's yearly foreign assistance budget through the United States Agency for International Development (USAID).

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<sup>52</sup> Interview: Winkie Williamson. Strategic advisor, Jordanian Hashemite Fund for Human Development. November 15, 2006;

Since the 1997 fiscal year, this budget has included a substantial grant in the form of a Cash Transfer to the Jordanian government. According to USAID, the Cash Transfer Program to Jordan provides a means for the Jordanian government to pay down its external non-military debt and strengthen its currency position. However, this reasoning did not reflect the response from Ministry of Planning official Ghaith Zureikat about the Cash Transfer program:

The Cash Transfer allows us a little bit more leeway about how we budget our government expenditures. With the Cash Transfer, we are able to pay our public school teachers fair wages, and also expand the government projects in capacity building and improvements in infrastructure.<sup>53</sup>

Still different was the response from former Jordanian foreign minister Jawad Anani when questioned about the Cash Transfer to Jordan:

For the past ten years, Jordan has been constantly expanding the size of its public sector. Currently, there are twenty-nine ministries, each with its corresponding bureaucracy and leader. In reality, Jordan has a population of just fewer than six million, or about the size of the Metropolitan area of Houston in the United States. The government sector is huge and funding for twenty-nine ministries is not easy without a corresponding large tax burden. As this is not politically feasible in Jordan, the Cash Transfer, along with any external flows into the government budget, helps this huge public sector stay adequately funded.<sup>54</sup>

The Cash Transfer is an integral part in the United States-Jordan partnership as it helps confirm the United States' positive strategic commitment to Jordan, and it is likely

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<sup>53</sup> Interview: Ghaith Zureikat. Head of Division, Ministry of Planning and International Cooperation (Government of Jordan), November 21, 2006.

<sup>54</sup> Interview: Jawad Anani. Former Jordanian Foreign Minister (Government of Jordan), November 7, 2006.

that the funding (nearly US\$150 million per year) does a bit of each of the aforementioned purposes. Tracing the path and uses of the Cash Transfer is more revealing of Jordan's behavior towards a potential MCC aid compact than tracing other types of aid transfers from the United States because of its similarity in structure and form to the MCC compact. Both espouse country "ownership of funds" after aid is disbursed. Furthermore, this highly desirable type of aid and the possible dependence of a public sector bureaucracy upon its disbursement would explain why the Government of Jordan would decide to seek aid funds despite a low absorptive capacity.

However, is the Jordanian government engaging in "rent-seeking" behavior in applying for additional MCC funding? In order to purport that Jordan is behaving in such a manner, we must be able to observe a certain distinct pattern of behavior in their policymaking processes. Specifically, if the political survival model proposed by Bueno de Mesquita were to be correct in the case of Jordan, we would expect that Jordan would alter its domestic policy decisions in favor of specific preconditions of aid proposed by the United States and the MCC.

The determinants to Jordanian government preferences are also paramount in understanding the strategic actions of the recipient. In Jordan, a constitutional monarchy, power is highly centralized with King Abdullah as the main executive. However, the stability of his reign is dependent upon the continued support of the members of his selectorate. Specifically, ethnic Jordanians (rather than Palestinian or Iraqi migrants) make up the base of his selectorate, and the appeasement of their interests is a necessary facet of Jordanian policymaking in order to ensure the stability of the Hashemite regime. The relationship goes both directions, however: the ethnic Jordanians continually struggle

for social and political standing against other ethnic groups, namely the ethnic Palestinians and the Islamist coalitions (IAF).

In order to ascertain what kind of behavior Jordan exhibits in reaction to the prospect of an MCC grant, the next section will be devoted to exploring the 2006 Threshold Country Plan Grant from the MCC to Jordan in detail. Again as mentioned in Chapter 2, the MCC uses their threshold country programs (when applicable) as an additional litmus test of good behavior apart from the seventeen good governance indicators.

Understanding Jordanian domestic policy behavior in the face of this Threshold grant is useful as we can determine whether Jordan is engaging in rent-seeking behavior. If Jordan is altering its behavior with the prospect of aid funds, we can expect a short-term credible commitment to donor preferences over domestic commitments, but a departure away from donor preferences in the long term, all other things equal. As is modeled much more fully in Chapter 5, Jordan perceives the kind of oversight over its behavior to be strong in the short-term, when the prospect of the compact is new. As time passes, however, the MCC becomes less stringent in oversight and Jordan will be more tempted to act contrary to donor preferences in favor of other domestic policies that are politically advantageous.

*A Litmus Test for Behavior – the September 2006 MCC Threshold Country Plan Grant to Jordan*

In September 2006, the MCC Board of Directors approved a Threshold Country Plan Grant up to \$25 million over two years. The program (still in progress) aims to focus on three of Jordan's deficient indicators—"Political Rights," "Voice and Accountability,"

and “Trade Policy”—in order to help Jordan start to make progress in these areas of good governance before a full compact is granted. A main motivating factor in choosing a Threshold grant rather than a full MCC compact was the 2006 Jordan country reports from both Freedom House and the Heritage Foundation.

In Freedom House’s 2006 edition of “Countries at the Crossroads,” the article made clear of the two main reservations of Freedom House—“political rights,” and “voice and accountability.” According to the report, “Jordan has reversed course, and the actions of past years no longer demonstrate a clear commitment to democratization.” They report that citizens are not able to openly criticize the government, especially after the November 2005 terrorist bombings in Amman. Since then, the government has had a greater fear of instability:

In reality, their survival depends very much on politics, specifically, formal constitutional powers over all branches of government and informal cultivation of support for a narrow segment of society and manipulation of opposition by the wider segments.<sup>55</sup>

These assessments from independent organizations like Freedom House on Jordan’s poor rating on certain MCC indicators, particularly the indicator on political rights, was a main determinant in the MCC decision to grant a Threshold Country Plan Grant rather than proceeding to full compact status. Furthermore, since the level of good governance in Jordan was in question, the MCC wanted to use the Threshold grant as a “test run” for Jordan, almost as another indicator of Jordan’s effort to follow the MCC principals of “ruling justly,” “investing in people,” and “economic freedom” on a broader

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<sup>55</sup> Freedom House: Countries at the Crossroads 2006, Country Report: Jordan. Available at: <http://www.freedomhouse.org/modules/publications/ccr/modPrintVersion.cfm?edition=7&ccrpage=31&ccr country=118>.

scale. These sentiments were reflected in a November 2007 interview with MCC Policy Officer Bradley Parks:

If a recipient country does not fulfill their Threshold plan requirements in full, the MCC is much less likely to entrust them with a full MCC compact. We follow the progress of a country's TCP very carefully before signing a full compact.<sup>56</sup>

While this may be an aspect of stated MCC policy, it is important to ascertain whether Jordan actually perceives a credible commitment from the United States, or if they believe that they can shirk on their responsibilities through the TCP grant. The key to ensuring that the MCC is creating an incentive effect in potential recipients like Jordan is to observe a change in governmental priorities and attitudes, along with a corresponding change in policy. Indeed, the author of the TCP grant, Stephen Carpenter, observed a marked, tangible change in both attitude and government policy in the first months after the TCP grant was approved:

As far as my observations in the Ministry of Planning (MOPic) about the incentive effect, it was a very real thing when the threshold grant was getting enumerated and fleshed out. There was a real buzz to implement reform and actually do what all these reforms intended to. This buzz was so great that the Ministry of Planning started developing a new local governance initiative in accordance with the Threshold requirements, with the approval of the King and his cabinet.<sup>57</sup>

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<sup>56</sup> Interview: Bradley Parks. MCC Development Officer. November 28, 2007.

<sup>57</sup> Interview: Stephen Carpenter. ARD Incorporated Staff Associate; Author of Jordan's Threshold Country Plan; Chief of Party, Customs Administration Modernization Program (Jordan), November 17, 2006.

At this stage in the analysis of the Jordanian Government after MCC involvement, it is difficult to know that there is causation between the MCC effort and Jordan response. Also, it is unclear whether the perceived change is because of the MCC incentive effect or is a common “aid-seeking” response to potential aid flows because of their dependence on funding. However, *these two situations are not necessarily mutually exclusive*. If I am correct in asserting that the Jordanian Government is a rent-seeking entity whose expected behavior is to pursue aid funds, it should not be surprising that the incentive to change government policy to be very high in the short-term. Over a longer period of time, this incentive to change may diminish in favor of other, more politically favorable alternatives if Jordanian Government does not perceive the MCC’s commitment as credible.

In November 2006, two months after signing an MCC TCP grant, the MCC announced the compact eligible countries for the next fiscal year. The list included Jordan, despite its aforementioned deficiencies in political rights, trade policy, and voice and accountability. Indeed, there were real concerns in the aid community that this action by the MCC would diminish its credibility and give a free pass to the Jordanian Government to cheat. One such reaction was that of Mara Galaty, a democracy officer for USAID Jordan and a liaison to the Millennium Challenge Account.

It’s a very strange thing when MCC compacts are agreed upon in the same year as a threshold grant, especially within two months of each other. Now, USAID’s job is to ensure, to the best of their abilities, that the Threshold Grant will still be used properly and effectively, now that the incentive for reform may be diminished.<sup>58</sup>

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<sup>58</sup> Interview: Mara Galaty. United States Agency for International Development, Jordan (USAID Jordan), Democracy Officer: Social Sectors Office, November 16, 2006.

Author of the Threshold grant Stephen Carpenter reflected these sentiments even more strongly:

The current state local governance is the central government (led by the King) does all the mayoral appointments, and half of the local council is appointed and half elected. This definitely limits voice in both local and national governments in Jordan. The proposed MCC Threshold reform looks to devolve the government and make it more democratic. If the reform that was agreed to between the MCC and GoJ goes through, all mayors and local officials will be elected (as per the agreement in the Threshold Grant).

Like I said, at first, there was a huge push to get this reform through; whether that can be attributed to true to commitment to reform or an incentive for a big aid contract, I don't know. However, as you know, in recent days, the MCA announced that Jordan would be compact eligible in 2007, which comes on the heels of the Threshold signing. The question is: does this nullify the incentive to follow up on the Threshold Grant and the actual reform demanded (including the devolution law)?

Already in parliament and in GoJ cabinet, there are caveats to the law, including one that would exempt cities that contain more than 300,000 people from the devolution. That would include three cities: Amman, Zarqa, and Irbid. Together, these three areas consist of 60% of Jordan's population. Moreover, Zarqa and Irbid are the home of two specific populations in Jordan, the Islamists and the Palestinians, that have been explicitly and purposefully shunned from the democratic and governmental process in the past in order to keep the status quo regime strong and in power. If this caveat is included in the law, the law will not achieve the devolution and increase in voice and accountability that the MCC had originally intended.<sup>59</sup>

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<sup>59</sup> Interview: Stephen Carpenter. ARD Incorporated Staff Associate; Author of Jordan's Threshold Country Plan; Chief of Party, Customs Administration Modernization Program (Jordan), November 17, 2006.

These sentiments reflected my own concerns about the potentially damaging effect the MCC's early announcement could have on a MCC incentive effect in Jordan. If the Jordanian Government knew that the MCC could approve a compact without Jordan having to fix the deficiencies as delineated in the Threshold Grant assessment, they would likely deviate from the MCC's wishes and not implement these reforms fully. However, in interviews with current Jordanian government officials, I was assured that reforms for the Threshold Country Plan would proceed as promised without any changes. Indeed, this promise and the potential for sweeping governmental reform with the TCP grant was a selling point to MCC CEO John Danilovich when he visited Jordan in November 2006. When asked how Jordan managed to secure the compact within such a short amount of time, Ministry of Planning officer Ghaith Zureikat clarified the Jordanian Government's perspective on the matter in late 2006:

What the outsiders and those not explicitly in the compact negotiation process don't know is that it was more important to the Millennium Challenge Corporation to see significant change in the formerly deficient categories. Clearly in each trend of Political Rights, Voice and Accountability, and Trade Policy, there has been an upward trend of positive reform since 2002. These dramatic changes, while not yet at median level, if given the correct initiative, will surely be reached if improvement trends stay consistent. Essentially the rhetoric between the Government of Jordan and the MCC has been convincing enough for the MCC to award compact status, in order to push us over the top. The Millennium Challenge Corporation's CEO John Danilovich met with Jordanian and international NGOs, King Abdullah, the current PM, and members of the media. This, coupled with the Jordanian plan of electoral and economic reform, convinced him.

The TCP grant will continue as planned, and for Jordan and USAID, it is a top priority for us. Although there have been concerns about passing the local electoral reform through parliament, I am not worried. It will reach the top of the agenda by the Spring of 2007 and I am confident that it will pass.<sup>60</sup>

Indeed, Mr. Zureikat was correct in his prediction that the local election law would pass parliament in the spring of 2007, seemingly proving incorrect the worries of TCP architect Stephen Carpenter and others in the aid community in Jordan. The first elections under this new electoral law took place in May 2007. However, although the United States Ambassador to Jordan declared the election “free and fair”, outside electoral observers from the Washington Institute for Near East Policy noted that the Islamic Action Front or IAF (the main opposition group to the status quo) withdrew during the election, alleging that the government was engaging in electoral fraud. During the May elections, observers saw buses of government and military personnel being brought to some of the voting sites. The Islamists cried foul on this action (whether it was initiated purposefully by the government remains unknown), and have denounced the outcome of the May elections as “an assault on democracy.” According to a December report by the Washington Institute:

The government was determined to forestall Islamist victories in major cities by encouraging the military to vote en-masse against the Islamists. Some independent

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<sup>60</sup> Interview: Ghaith Zureikat. Ministry of Planning and International Cooperation (MOPIC), Head Division, Government of Jordan, November 21, 2006.

observers in Jordan even claimed that government-sponsored irregularities further undermined Islamist chances in the municipal contest.<sup>61</sup>

The report continues by saying that the government feels threatened by the IAF, not because of the potential for change, but because of the IAF's ties to Muslim groups like Hamas and the Muslim Brotherhood not friendly to the United States and friendlier to Iran and Hizbollah. While the Washington Institute acknowledged that the Muslim Brotherhood's claims of electoral rigging may have some foundation, their potential support for illiberal goals and means provide little chance for sympathy by outside observers.

While the successes and shortcomings of the local electoral reform are still unclear (and Jordan's rating of political rights remains the same as past years), Jordan has shown great improvement on another focus area of the Threshold grant, the "trade policy" indicator. Since the fall of 2007, the author of the Threshold Grant Stephen Carpenter also was given the position of chief of party in charge of improving Jordan customs. In a February 2008 interview with Mr. Carpenter, he expressed that he was pleased with the fast reform of many customs regulations. He noted:

There are certain areas of reform that seem to be completely uncontroversial and that recipient governments have the greatest incentive to improve. Usually, these are the economic indicators that are non-political and will only serve to make the status-quo look better. Customs reform is much easier, and much more likely to be successful than sweeping electoral reform that could potentially change the makeup of the regime.<sup>62</sup>

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<sup>61</sup> Hassan Barari. "Elections in Jordan: Poor Showing for Islamists," The Washington Institute for Near East Policy, Policy Watch Paper #1317, December 13, 2007. Available at: <http://www.washingtoninstitute.org/templateC05.php?CID=2693>.

<sup>62</sup> Interview: Stephen Carpenter. ARD Incorporated Staff Associate; Author of Jordan's Threshold Country Plan; Chief of Party, Customs Administration Modernization Program (Jordan), February 27, 2008.

The aid initiatives that have the most trouble being implemented are those that are politically contentious. Aid initiatives that are politically advantageous (like the customs reform initiative) are implemented promptly and effectively, even over the long term and under less-than-optimal oversight by the donor. Initiatives that are politically unappetizing may be accepted at first, but the efforts to implement these programs grow weaker as other politically advantageous opportunities are presented.

***Overall Picture: Jordan and the MCC incentive effect***

Given its dependence upon foreign aid funds in the past and the prospect of receiving a substantial MCC compact, there is a substantial incentive for Jordan to sustain its original commitment to MCC preferences. In the short run, these incentives will likely shape Jordanian Government behavior. Indeed, these interviews in Jordan support the case that this incentive effect is real and provoked a tangible response from policymakers. Over time, I hypothesized that this effect may diminish in favor of more viable political alternatives. According to the interviews in Jordan, however, it appears that this effect varies over the type of program. Initiatives to improve trade policy and customs in the country have proven to be a highly successful part of the TCP grant, and this incentive to perform better on this indicator benefits both the MCC and the Jordanian Government. Here, we observed full compliance by Jordan to the MCC. On the other hand, the local electoral reform was clearly a difficult decision for the Jordanian Government to accept, but one required by the MCC. They approved the measure, but have had accusations of electoral rigging in favor of the status-quo regime. Perhaps the alleged electoral riggings

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were a by-product of the Jordanian Government shirking from their commitment to the MCC, or perhaps it occurred because Jordanian electoral politics were not ready for such sweeping reform.

Nevertheless, Jordan remains on track to sign a full compact within the next year or two. Currently, Jordan is in the contract formation process, consulting with different aid actors and experts to form appropriate programs that the MCC approves. This process has been delayed because of bureaucratic ineffectiveness in Jordan and the slow process of proposal development, but the electoral troubles have not prompted a re-evaluation of compact eligibility to this point.

Jordan will continue to walk the tightrope between political necessity and adhering to MCC principals such that they can both improve the status quo position in government and guarantee MCC compact funding.

## **Part III: Analysis and Model**

### **Chapter 5**

#### ***A Model of Strategic Actions during the Aid Transaction: Credibility, Cheating, and Strategic Planning***

Now having laid out the interviews from both the MCC's officers and Board of Directors in Washington, D.C. and from aid workers and government officials in Jordan, it is appropriate to draw some tentative inferences about the interaction between these two sets of actors. Since this paper postulates that these interactions are systematically derived from the credible commitments and perceptions of each actor rather than stochastic and ad hoc decisions, this chapter seeks to model actor behavior in the case of MCC and recipients.

The implications of this model are only as strong as the assumptions that are made clear before the model is produced; the best models are able to accurately reflect the values and intuitions of real actors, as the parameters of the model must reflect the real situation placed in front of these actors. Models do have limitations because they attempt to simplify and systematize decision-making, but often, political decisions are strategic. Since the strategic interaction between the MCC and Jordan is complex, I develop this model to analyze the factors that are vital in this transaction: credibility/ reputation, expectations, and information.

It is paramount that the model captures the fact that recipients will look to cheat on MCC rules and expectations, and that the MCC often is cognizant of the potential of cheating by recipient countries. Furthermore, the recipient's expectation of donor scrutiny is given and varies over time, and this may affect the potential for recipient cheating as well. If the model is able to capture these dynamics, then we can accurately assess the conditions under which recipients will actually reform, and also the conditions under which the MCC may or may not grant compact funding.

The following assumptions of the strategic interaction between donors and recipients (as indicated by the MCC-Jordan case study) are built into the model:

1. *Expectations and Commitment Problems.* Policymakers suffer from commitment problems that vary at different times of the transaction. In the short term, recipient governments look to make themselves as viable a candidate as possible for future MCC funding. Therefore, they will devote short-term resources to improving good governance indicators as is demanded by MCC standards. In the long-term, however, once recipients like Jordan have forged a strong relationship with the MCC, the temptation to defect is stronger (depending on the level of scrutiny and other domestic factors). The model will treat defection as a random variable, accounting for the possibility that recipients governments like Jordan may make a commitment in good faith to the MCC (and actually intend to reform and change good governance standards) but fail to do so because of unforeseen circumstances (i.e., domestic political restraints). The 'temptation parameters' are treated as

privileged information available disproportionately to recipient governments, as they are much more privy to the domestic constraints and activities than donors.

2. *The Implications of Reform.* There is some relationship between good governance reform and maintaining the status quo in recipient countries, as demonstrated in Jordan. In some cases, recipient governments can implement good governance reform and maintain or enhance their political position. Other times, recipient governments may be unable to implement good governance reforms in fear that it may be politically unfavorable and alter the domestic balance of power (a good example of this is implementing electoral reform that would lead to the incumbent regime losing seats). These parameters are dictated by the attitudes of actors that hold the recipient government accountable. Usually, this may take the form of the electoral base in recipient countries, but it may be restricted to business/political elites (depending on who yields the power within the country), or even other actors with a considerate stake in government policy making.
  
3. *The MCC's Credibility Problem.* Although the MCC has a clear threshold for good governance and has delineated parameters for who is eligible for aid, the MCC Board of Directors has discretionary powers that allow it to approve compact on the margins that constitute a strong “opportunity to reduce poverty and generate economic growth within a country.”<sup>63</sup> However, interview evidence from both MCC and Jordanian government officials indicate that the degree to which this discretion is variable and can potentially favor strategic partners of the United

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<sup>63</sup> MCC website: [www.mcc.gov](http://www.mcc.gov)

States. The U.S. State Department, as a voting member of the MCC's Board of Directors, has the opportunity to push for leniency in hopes of future benefits in diplomatic efforts outside of the MCC. While this effect is not as developed in MCC decision making when compared to the IMF or USAID, the incentives to act in this manner are the same.

4. *Reputation.* Despite the aforementioned credibility problem, the MCC has on some occasions punished recipients for backsliding on promised reforms and levels of governance by the threat of suspending compacts. On March 11, 2008, MCC CEO John Danilovich sent the president of Armenia Robert Kocharian an official warning because of recent suspensions of media freedoms and electoral difficulties. The Gambia 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. The credible threat of punishment is necessary to ensure the MCC's ability to enforce compliance in future clients.

The structural choices of each of these actors are informed by each of the above systematic factors; while each of these factors plays a role, each decision is incumbent upon the time and the environment that exists. Each actor can be understood as utility maximizing entities that evaluate each situation carefully before acting. Now, with these assumptions in place, we can model the behavior of two such actors when a potential MCC compact is in place. The following model will reflect much of what has been discussed in earlier chapters in a clear cut analysis.

The dominant actor in this analysis is the MCC: they are the actor with the ultimate decision to make about disbursement of funds and therefore dictate the rules of the engagement. For the MCC, the goal is to maximize the incentive effect for good governance reform in recipient governments. However, there is a third set of actors: the independent organizations charged with providing the indicator data on the seventeen MCC measures. The MCC is therefore dependent upon the expertise of organizations like Freedom House and the World Bank.

The MCC has strict rules in which they determine eligible recipients: first, countries must fall under either the low income (under US\$1735) or the lower middle income (between US\$1735 and US\$3595) categories of gross national income (GNI) per capita as measured by the World Bank. These categories include some ninety-six countries that constitute the subset of MCC eligible countries. In addition, the MCC will not award any monies to countries subject to United States or international sanctions. This is the first way that the MCC is beholden to U.S. strategic interests (although such standards are usually uniform throughout all U.S. government agencies).

Countries that fall in this category are aware of their eligibility and then attempt to qualify for official MCC approval by scoring above the median on more than half of the seventeen MCC indicators, including above the median for the mandatory proxy of corruption. Therefore, potential recipients can shift their policies in order to improve on their deficient indicators. The MCC also (unofficially) uses their Threshold Country program as a “trial-run” or a litmus test for good behavior for countries on the margin; countries that perform well in implementing the Threshold grant are more likely to receive a full compact later on.

Notably, the MCC begins to monitor country performance closely once they approach the threshold of eligibility. At times of high scrutiny, recipients are likely to exhibit high levels of compliance. Scrutiny and oversight can manifest itself in different ways. In some cases, the MCC sends their own officials to observe good governance progress in recipients, but usually, the MCC depends on country reports from those independent organizations in charge of measuring MCC good governance indicators.

In this particular environment, the model will now show the probable decision-making processes of the main actors as a function of their utility-maximizing strategic behavior:

#### *The Millennium Challenge Corporation*

There are multiple factors that affect the MCC's utility in this model. First, the MCC has the mandate to act under the goal of "reducing poverty through economic growth." In the strategic decision-making process, the MCC weighs the potential of reducing poverty in prospective recipients very seriously. Second, the MCC places a high emphasis on good policy environments in recipient governments, such that a country's performance on the seventeen MCC indicators serves as the first criteria for a potential MCC compact. Third, *ceteris paribus*, the MCC wants to disburse as many compacts as possible given the constraints of their own system. The intuition behind this is two-fold: 1) the MCC is a typical bureaucracy in government that looks to sustain its own existence by showing that they are doing meaningful work,<sup>64</sup> and 2) the MCC in Washington has been under enormous pressure from Congress to approve more compacts and disburse

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<sup>64</sup> See resource dependency theory (RDT) in the microeconomic literature for more on this phenomenon in both business and governmental bureaucracies.

more funds. In the MCA budget hearings of 2005, Congressional members showed skepticism towards the MCA because of its reluctance to approve compacts to countries, even despite the fact that countries not qualifying outright for MCA assistance with the seventeen governance indicators.<sup>65</sup> Additionally, I argue that this pressure to disburse funds is not uniform across all potential recipients; the MCC (and the U.S. government on the whole) has increased utility in granting compacts to countries that figure prominently in the foreign policy priorities of the United States in hopes of forging good relations in the future. Concurrently, however, giving funds to strategic partners has the threat of moral hazard as certain countries realize that they may be able to cheat more easily, and the use of funds of a government with bad institutions is precisely what the MCC opposes.

### *The Recipient Governments*

Each recipient government when forging a credible relationship with the MCC makes a commitment to pursue policies that reflect the MCC's preference of good governance. The MCC chooses to take into account a wide variety of measures of governance and economic performance. Although this may seem like a more stringent level of accountability demanded of the MCC, it is much harder for the MCC to account for this inclusive list of requirements. Potential recipients understand this fully, but want to be safe about securing aid money. Therefore, the size of recipient's utility (benefit) of improving each of these governance indicators becomes directly influenced by the other potential benefits from pursuing other goals. In this respect, countries may assess how

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<sup>65</sup> Sarah Lucas. "Lessons from Ghana 2: Managing Political Pressures at Home and Abroad." Field Report: MCA Monitor, Center for Global Development. Available at: [http://www.cgdev.org/section/initiatives/\\_active/mcmonitor/fieldreports/ghanafield/ghanalesson2](http://www.cgdev.org/section/initiatives/_active/mcmonitor/fieldreports/ghanafield/ghanalesson2).

politically advantageous a given initiative is and choose to implement or not implement accordingly. Furthermore, governments cannot perfectly predict exactly what political constraints and opportunities may arise in the future, weighed against the benefits and costs of reforming MCC governance indicators.

### *The Selectorate of Recipient Countries*

As highlighted in earlier chapters, the selectorate is the set of actors that have an institutionally granted say in choosing, influencing, and removing a given country's leaders. They are usually made up of political and economic elites, interest groups, socio-cultural groups, and other important political actors. These actors are responsible for indirectly dictating the strategic preferences of recipient governments and the commitments that result from these preferences: while they are not part of the formal decision-making process, the selectorate's preferences are hugely important to recipient governments. The selectorate benefits directly from the status quo regime. Therefore the selectorate wants to support decisions that increase the existing regime power and domestic support. However, as the lynchpins for the existing government, they also demand a certain type of security from recipient governments: that their preferences regarding social and political hierarchy and benefits are maintained. In practice, the selectorate finds maximum utility in initiatives that reinforce the status quo regime (and therefore bolster their socio-political standing in the country). They discourage programs that are not in their interest, even if such programs may encourage democracy.<sup>66</sup>

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<sup>66</sup> In some situations, the selectorate's preferences would deviate significantly from the idea of "democracy" because they are the benefit of some type of socio-political stratification. Further implementation of "democratic reform" initiatives may threaten this existing system.

### *The Independent Governance Monitors (IGMs)*

Independent governance monitors serve as impartial but nevertheless important players in this model. Organizations like Freedom House or the Heritage Foundation are the “middle-men” between recipients and donors: they often have the capacity to be on the ground of potential recipients, using their larger bureaucracies to gather information about a country that a small agency like the MCC would struggle finding. For the purposes of this model, these organizations do not have increased utility in making strategic partnerships with a recipient, and are therefore only focused on monitoring whether a country meets good governance or not. While IGMs can give counsel to recipient governments as to ways that recipients can achieve better indicator scores, their main capacity is to report country progress on the seventeen good governance indicators, serving as “fire-alarms” in monitoring recipient behavior. In this manner, we can view the opinions of IGMs as the most transparent actor. All information is public, and there is a clear objective: measuring and reporting good governance levels.

### *Equilibrium*

With the preferences and goals of each utility-maximizing actor clear, we can now find equilibrium based on the credible strategies and rational beliefs of all players. Actors will only make decisions that are in their interest given a certain understanding of the credible commitments of other actors. These conditions will change over time, but the

model assumes that at any point, an actor will act according to its perception of its interests.

It is likely that a recipient such as Jordan may, over time, begin to fall short of MCC expectations (either purposefully or because of domestic constraints), and once such a fall is realized by the IGMs, the MCC would increase its level of scrutiny temporarily. The MCC may demonstrate this increased oversight by implementing police-patrol oversight (sending MCC officials to a country for a couple days to observe behavior), but they lack the resources to sustain this type of oversight over long periods of time. In some situations, the recipient would feel the increased pressure due to the MCC's corresponding increase in oversight. In fear that bad behavior may lead to a denial of an aid compact, recipients would work hard to improve their good governance indicators once again. Alternatively, recipients may show an upward trend in good governance indicators in this situation only initially. After this preliminary push, however, countries may allow indicators to stagnate once again depending on their perception of MCC oversight.

In this model, the optimal strategy for "aid seeking recipients" applying for MCC compacts is to show a credible push at the beginning of the aid transaction. This is to show maximum credibility at the point of greatest MCC scrutiny. It is common for levels of scrutiny to be high at the outset of the transaction because the MCC cannot wholly know how a potential recipient will regard MCC rules.

After the MCC has established that a recipient is working in good faith and is showing signs of improvement, policymakers in potential recipient governments can follow one of three paths (modeled in Figure 5.1):

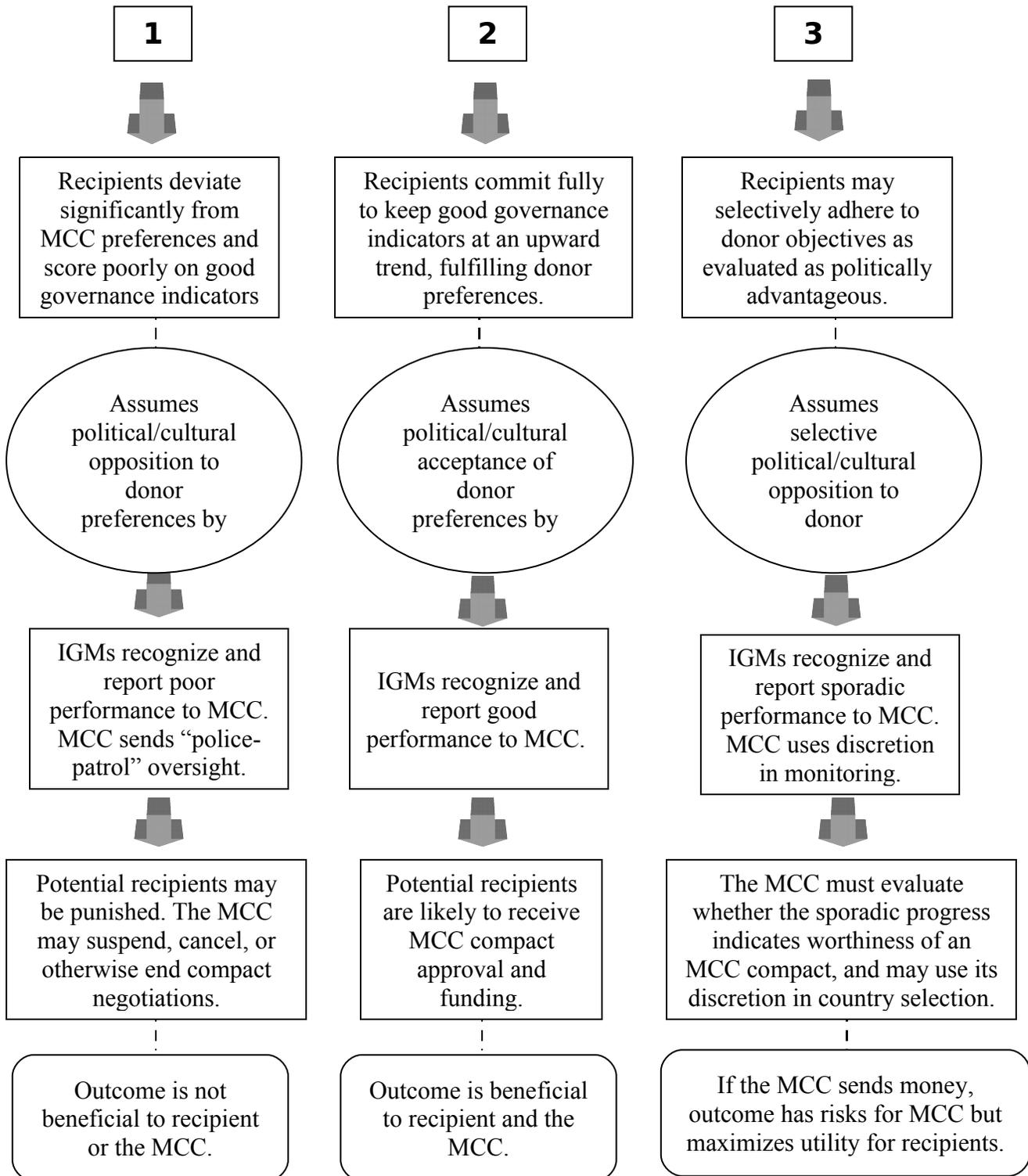
1. Recipients can deviate significantly from adhering to good governance indicators in favor of more politically advantageous alternatives.
2. Recipients can remain wholly faithful to donor objectives and continue to commit resources and effort to keep indicators at an upward trend.
3. Recipients can find some middle ground in which they adhere (or appear to adhere) to donor objectives, continue to keep indicator levels constant (or showing improvements in some select areas that are politically advantageous), and remain open to other politically beneficial alternatives.

The first potential path delineated above is the least viable for recipients that place aid as a priority. IGMs will soon recognize this shift in behavior, especially if it causes a corresponding drop in good governance performance. They will write scathing public reports about these failings, forcing the MCC to disregard the notion of giving aid monies even if a country was politically favorable. The second is a viable option for countries that desperately need aid and are willing to sacrifice their other policy concerns in favor of ensuring aid flows. This would be possible only if the selectorate of the recipient country showed support for such a decision. In Jordan, however, this was not the case as the selectorate felt directly threatened by an increase in good governance (as manifested by open elections). In such a case, the third path is the only option. Recipient governments must find a balance between catering to their own needs in sustaining their political advantage while also preserving a good enough relationship with donors that potential aid flows are not in jeopardy. Such a mandate is the hardest to achieve given conflicting goals.

The third option is also the only path in which the utility of the donor is a large factor.

In either of the two other paths, the donor has no choice in the matter of disbursement

**Figure 5.1**  
**Three Paths of Recipient Behavior to the prospect of an MCC Compact:**  
**The Variance of the MCC Incentive Effect in Recipients**



according to its own rules. Countries that fail miserably enough on indicators cannot be considered, and countries that clearly show a commitment to good governance pass with flying colors.

Countries on the fringe, however, are the ones that may or may not fund depending on the amount of utility the donor receives in disbursing aid in each case. All things equal, the MCC will want to disburse aid because of their desire to prove that the MCC is an important organization (to answer the critics of the MCC discussed in previous chapters). However, *countries that are deemed as strategically important have a significant advantage over other countries because of the added utility of giving them an aid compact over their competitors.*

### ***Dynamics of Equilibrium***

As shown in Figure 5.1, this model puts a large emphasis on the role of the selectorate in deciding policy. Although the MCC remains the main “principal” in the model as the actor who ultimately approves disbursement, the selectorate represents the “domestic principal” in the model, or the actor to which the recipient governments are accountable in order to keep the status quo regime in power. Therefore, Figure 5.1 demonstrates the “tightrope walk” that results from the third path in the model as discussed in great detail in previous chapters. IGM behavior in the model is taken as exogenous and given.

Essentially, the term “politically advantageous” in terms of recipient preferences is qualified as the course of action that maximizes the utility of the selectorate and the status

quo regime. In some cases, acquiring aid funding is the utility-maximizing endeavor; other times, political options that undermine the possibility of aid funding are necessary and utility-maximizing. In the most ideal cases, the reforms proposed by the MCC and the incentive placed on these reforms is enough to make this choice both utility-maximizing for the recipient governments, selectorate, and the MCC. This is the intended outcome if the MCC is to be considered an institution that permeates good governance “norms” in potential recipients.

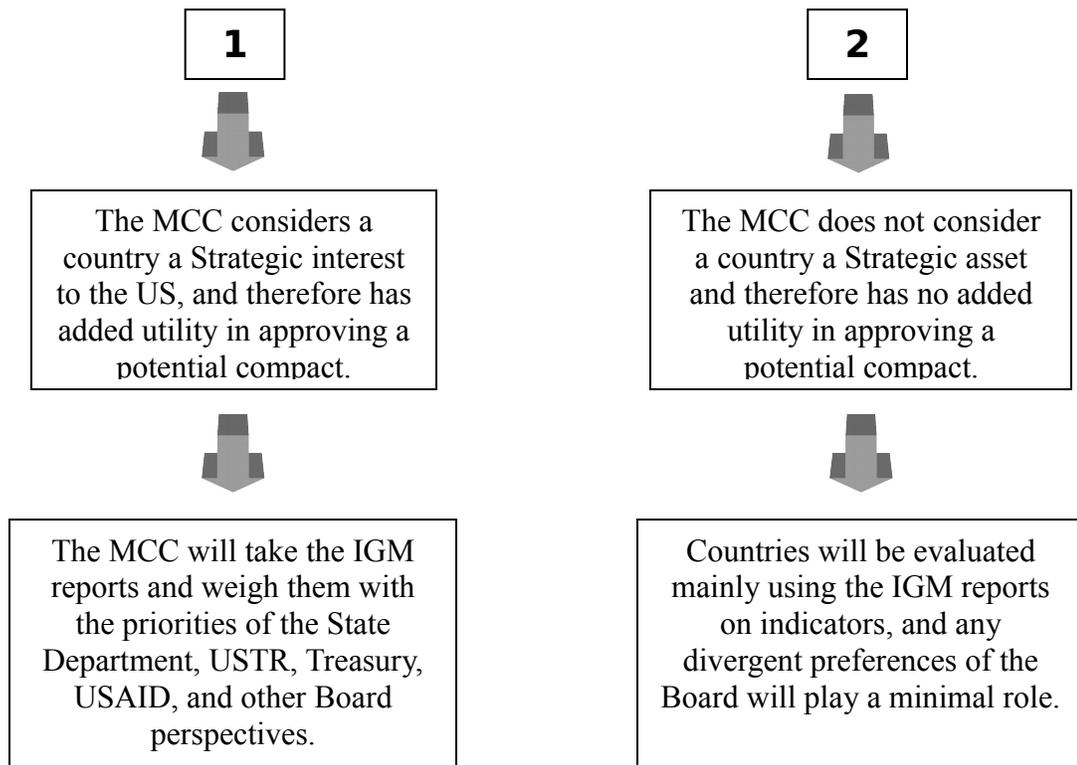
An important facet of this model is that a shift in selectorate preferences, or alternatively, an alteration of the makeup of the selectorate, can dictate a change in the strategic choice of the recipient. For example, a country may begin to follow the first path of recipients and not devote any additional resources or effort into deficient indicators. As the incentive of potential MCC monies gets more enticing, however, recipients may choose to selectively implementing governance reform (path 3) or even wholeheartedly pursue MCC goals (path 2). Alternatively, a country may start off by trying to improve good governance indicators wholeheartedly (path 2), but a political shock to the system may cause some initiatives to be political “non-starters” (this was precisely the case in Jordan in November 2005 after terrorist bombings took out three main hotels in Amman). Because of this political shock, recipient governments may need to deviate from donor preferences unwillingly to ensure stability, resulting in a shift to path 3 or even path 1.

While this interpretation of strategic behavior is recipient driven (that is, based on the actions of the recipient selectorate and government), it is also possible that this decision tree be MCC driven to reflect both the level of scrutiny and the multiplicity of

priorities represented on the MCC Board when deciding on countries that are on the margins. This situation is modeled in Figure 5.2.

Figure 5.2 demonstrates that the MCC will pursue the course of action that maximizes their utility. Both paths generate a positive utility for the MCC if a grant is eventually awarded because it seeks, *ceteris paribus*, to get money out the door when possible without compromising its credibility as an institution. However, there is an added incentive to award a compact because of strategic benefits for the MCC in path 1 that increases utility for that outcome; therefore, we can expect a subsequently lower weight on the democratic indicators than a country that has no strategic importance.

**Figure 5.2**  
**The MCC Decision-Making Process with Countries on the Margins**



**Conclusions – How does the model inform our knowledge of the MCC effect?**

In this model of the strategic interactions between the MCC and potential recipient countries, the MCC is treated as a utility-maximizing actor who receives some utility in granting compacts generally, but receives added utility in giving funds to countries that are strategic partners of the United States. Therefore, the MCC likely alters its strategic behavior to some extent in order to facilitate this extra utility acquired by granting strategic compacts. However, if this behavior places less emphasis on the MCC's seventeen good governance indicators (as is modeled in this chapter), the incentive effect is diminished (as the credibility of the MCC is decreased). However, the MCC does care about its reputation and credibility, and will only use this discretion if countries fall on the margins.

The MCC incentive effect also varies in response to recipient government behavior. The model depicts three potential paths, each varying depending on the preferences of the recipient country's selectorate (a main determinant in the model). Recipient governments look to sustain their political advantage while maximizing their utility. Therefore, if the MCC presents reforms that are considered to be politically viable and advantageous to the recipient selectorate and government, the incentive effect will remain strong. If the MCC's requirements are damaging to the political status quo or the reforms are political non-starters for the selectorate, the incentive effect is very weak. Finally, when some aspects of reform are politically viable but others are politically difficult, governments may be selective in accepting reforms, attempting to improve some indicators but not all. In this case, recipients walk a tightrope of political action between remaining a credible partner with the MCC on the one hand and appeasing the selectorate on the other. Here, the level of scrutiny and the political climate play significant roles in the analysis. As

such, the MCC incentive effect is variable: strong in some respects and areas and weaker in others.

## **Chapter 6**

### ***Concluding Remarks***

Despite the initiatives of the United States and others in the developed world to assist developing economies in the past century, there are still substantial barriers to success. The formation of the Millennium Challenge Corporation in 2004 was a recent and prominent attempt to address the intertwined issues of bad governance and economic stagnation in a new manner. As the previous chapters have shown, the politics of aid—with strategic decisions, “tightrope walking,” divergent preferences, credible commitments, and consensus building—play a central role in the success and failure of programs and are substantially difficult for policymakers charged with making these decisions. There is no doubt that the MCC offers the development community with a fresh outlook on country selection and aid disbursement, capitalizing on ex post incentives for good governance reform. Since the MCC has clear rules requiring countries to reach a certain threshold of good governance as measured by seventeen independently measured indicators, there is the possibility for countries to change policies and reform before aid is even sent.

This study set out to explore the nuances of this effect in recipient countries. Does the effect exist, and if so, when does it manifest itself? What dictates its strength and weakness in a given situation? I maintain throughout this paper that the MCC incentive effect does exist and is manifest in potential recipients, but the strategic behavior of the MCC Board of Directors and recipient governments play huge roles in dictating the strength of the effect. Specifically, when a country’s performance falls on the margin, the

MCC and recipient countries engage in a two-level game of credible commitments where each actor looks to maximize their utility.<sup>67</sup> As the MCC has varying levels of scrutiny on recipients and because recipient preferences are highly dependent upon their electorate, the outcome of the game and the corresponding strength of the MCC incentive effect are highly variable.

This paper presented the case of Jordan as the focal point of its analysis. While large-N statistical analyses allow us to generalize overall trends, descriptive case studies go “inside the numbers” and look at the specific reasons certain trends occur. The use of Jordan in this paper exemplifies this advantage: an understanding of these strategic games is dependent on the domestic political situation in a potential MCC compact recipient. Recipients like Jordan must tackle the political barriers to achieving the good governance scores needed in order to qualify for aid. If Jordan and other recipients are to reach the threshold of good governance and express a credible commitment to MCC standards, they must make a conscious effort to do so.

However, if the MCC is to utilize a strong incentive effect, it must also give a credible commitment to recipients and hold them accountable for their good governance performance. In practice, strategic preferences of those on the MCC Board of Directors may come in conflict with the MCC’s stated priority of good governance and possibly weaken the incentive effect. The limitations of the small MCC bureaucracy serve as an additional limiting factor in the MCC’s ability to assess recipients. They rely on “fire-alarm” oversight by independent governance monitors rather than “police-patrol” oversight by experts within their own bureaucracy. The Jordanian government knows that

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<sup>67</sup> For other examples of countries that fall “on the margin,” see Appendix D for the full list of MCC Threshold Country Grant recipients.

it benefits from the MCC Board's use of discretionary powers and shapes domestic policy decisions to take full advantage. In the short-term where scrutiny is expected to be high, Jordan can strategically demonstrate that they are making progress in good governance deficiencies. Over the long term, this level of scrutiny will not sustain itself, giving Jordan more incentive to cheat if it needs to in order to appease its electorate with politically viable alternatives.

### ***Contributions***

In conceiving this paper, I realized that too much is left unexplained in the current literature of aid disbursement and effectiveness. Due to the recent emergence of the MCC as a main actor in the aid community and the added importance of their involvement in Jordan, this study of the MCC incentive effect provided an opportunity to deconstruct the black box of political action in order to determine the exact factors contributing to a strong or weak manifestation of the incentive effect in Jordan. Notably, I acknowledge that not all countries act like Jordan or have political structures and culture that parallel that of Jordan; however, the purpose of this paper was to shed light on these interactions between the MCC and recipients and not to explain all potential permutations of behavior. Most compelling is that the case is ongoing: these strategic decisions are currently being considered by policymakers in Jordan. The MCC Board members and their advisors are currently forming opinions on potential MCC recipients and balancing the MCC priority of good governance reform within the framework of their own preferences.

This paper is policy relevant in a very real and palpable way. If the MCC were to be completely cognizant of the political cost-benefit calculus of potential recipients, they may be more equipped in providing recipients with the counsel needed to make these hard policy decisions. Furthermore, the MCC may be less willing to compromise its stance on good governance in favor of the strategic preferences of the State Department, US Trade Representative, Department of the Treasury, or even USAID if they thought that such a compromise would weaken the MCC incentive effect. Or perhaps they would not, knowing that the utility garnered from strategic partnerships with MCC recipients outweigh the costs involved with awarding a compact too readily to strategic recipients.

### ***A Final Look***

With the Bush administration coming to its conclusion, the Millennium Challenge Corporation is approaching a significant crossroad in its short existence. There are some that purport that the MCC is not a worthwhile aid organization because it has failed “to get money out the door” in the first years after its inception. However, granting compacts to more countries would mean that the MCC would have to be more lenient in its disbursement policy. This would undermine the novel approach that the MCC has towards country selection: be selective in who to trust with large sums of money if you want it to be effectively spent. The seventeen indicators of good governance serve as this proxy for selectivity, and when this threshold is strictly used, countries are rewarded with full ownership of funds and are able to create and implement the programs that they feel is most necessary.

While this is very different from the “need-based” aid approach of many organizations, the MCC does not believe that it is the panacea for all the ills of development policy. Rather, the MCC works in conjunction with other organizations in the collective effort to aid developing countries. Furthermore, the MCC successfully places good governance reform as a priority for developing countries. No more apparent is this aspect of the MCC’s role than in Jordan. While it is still unclear whether or not Jordan will make the reforms necessary to improve its indicators, or whether the MCC will approve the compact anyway because Jordan is a strategic partner, the MCC’s focus on good governance has brought governance reform to the forefront of its policy agenda. For a country that has no history of democratic governance or economic prosperity, this is a huge step. However, the success of Jordan and other potential recipients hinges on whether or not the MCC provides a big enough incentive to change institutionally embedded norms and codified laws. Therefore, the less discretion the MCC Board of Directors chooses to use, and the more fervently it stresses indicator scores, the more successful they will be in incentivizing reform and embedding these good governance norms in possible recipients.

In the months and years following the conclusion of this thesis, I look forward to the opportunity to travel back to Jordan to see if the Jordanian government and the MCC have made any progress on the potential MCC compact. If it does get approved and implemented, I am interested to see how the Jordanian government chooses to use the funding and I wonder if Jordan will continue to commit resources to improve good governance indicators. But more importantly, I look forward to seeing my host brother, Sharif, and his family.

With every visit to Jordan, I see the outward and inward manifestations of development, both good and bad. There are new bridges, new sky rise hotels and apartment complexes, and more traffic. Whether this change is manifest in the political and economic institutions of the country, however, is another matter. Sharif is still under-employed as a hotel administrator because of systematic rules preventing many ethnic Palestinians from holding government jobs. He laments the fact that he is not an ethnic Jordanian, that he is not part of the selectorate that wields social and political power. He worries that despite his best efforts, the systems of governance will fail to improve. He worries about the future of his family and of his country. For Sharif, the ramification of the MCC effect is not an issue of academic inquiry, but the potential for real change in Jordan's policies towards its own people. Neither Sharif nor I know exactly what the implications of Jordanian reform will be. Sharif only hopes that change will come soon, because he has been waiting for it for a long time.

**Appendix A.**  
**The Millennium Challenge Corporation's Seventeen Indicators of Good Governance**

### *Ruling Justly*

- Civil Liberties (Freedom House)
- Political Rights (Freedom House)
- Voice and Accountability (World Bank Institute)
- Government Effectiveness (World Bank Institute)
- Rule of Law (World Bank Institute)
- Control of Corruption (World Bank Institute)

### *Investing in People*

- Immunization Rates (World Health Organization)
- Public Expenditure on Health (World Health Organization)
- Girls' Primary Education Completion Rate (UNESCO and World Bank)
- Public Expenditure on Primary Education (UNESCO and national sources)
- Natural Resource Management (CIESIN and YCELP)

### *Encouraging Economic Freedom*

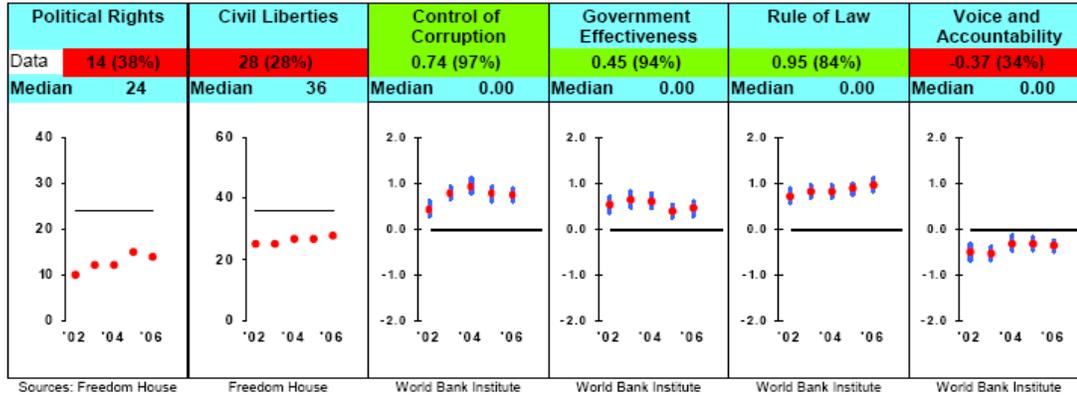
- Business Start-Up (IFC)
  - Land Rights and Access (IFAD and IFC)
  - Trade Policy (Heritage Foundation)
  - Regulatory Quality (World Bank Institute)
  - Inflation (IMF)
  - Fiscal Policy (National Sources; cross-checked with IMF)
- *Supplemental Information:* The Board may also consider information to address gaps, time lags, measurement error, or other weaknesses in the indicator to assist in assessing whether MCC funds might reduce poverty and promote economic growth in a country. For FY 2008, this will include: the disabilities component of the U.S. Department of State's Human Rights Report; Transparency International's Corruption Perceptions Index; and the Global Integrity Index, among other sources.

## **Appendix B. Country Scorecard: Jordan FY2008**

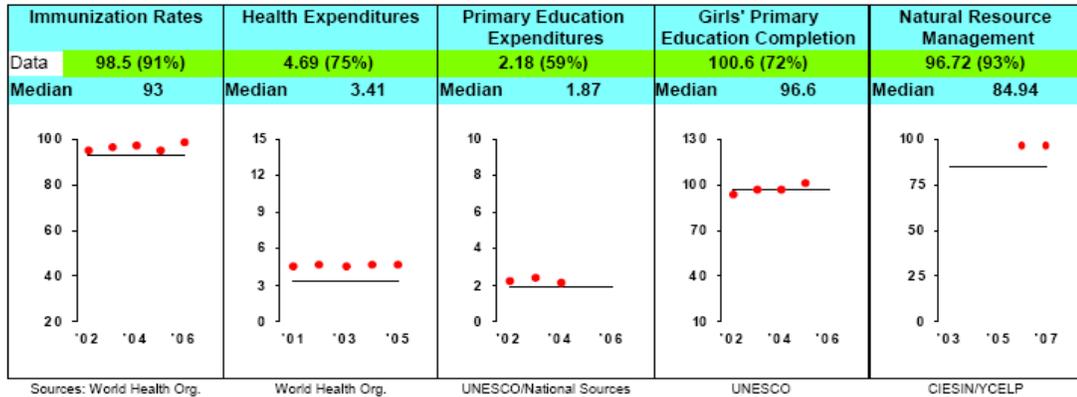
# Jordan FY08

Population: 5,473,000  
GNI/Cap: \$2,660 LMIC

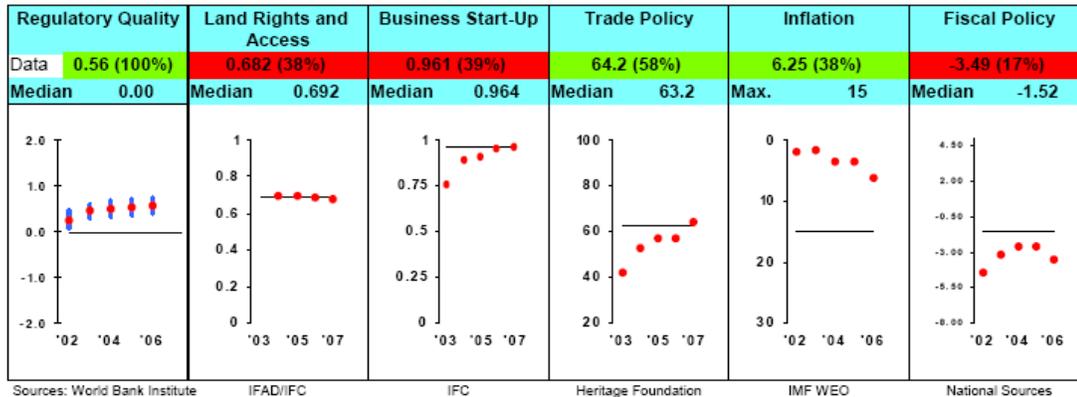
## Ruling Justly



## Investing In People



## Economic Freedom



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 and passing scores, or scores above the median, are represented with green. Failing scores, or scores at or below the median, are represented with red. 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](http://www.mcc.gov)

10/10/2007

## Appendix C Jordanian Federal Budget Analysis

## Summary of General Budget for the Years 2004- 2006

1000 JDs

Revenues	Actual 2004	Estimated 2005	Re-estimates 2005	Estimated 2006	Actual 2004	Estimated 2005	Re-estimates 2005	Estimated 2006	Expenditures
<b>1. Domestic Revenues</b>	<b>2138896</b>	<b>2000000</b>	<b>2505000</b>	<b>2764000</b>	<b>2326495</b>	<b>2545000</b>	<b>2873000</b>	<b>2607000</b>	<b>1. Current Expenditures</b>
<b>a) Tax Revenues</b>	<b>1428800</b>	<b>1368000</b>	<b>1726000</b>	<b>1855000</b>	<b>604471</b>	<b>673599</b>	<b>655806</b>	<b>698572</b>	<b>a) Civil apparatus</b>
1. Income Tax	217914	220000	282500	305000	604471	673599	655806	698572	1. Ministries and Civil Departments
2. Customs Duties	266907	208000	282900	310000	<b>653000</b>	<b>691050</b>	<b>691050</b>	<b>715000</b>	<b>b) Military apparatus</b>
3. General Sales Tax	827025	840000	1010900	1080000	405000	420000	420000	434000	1. Armed Forces
4. Taxes on other Domestic Transactions	116954	100000	149700	160000	53000	57270	57270	57500	2. Royal Medical Services
<b>b. Non-Tax Revenues</b>	<b>650432</b>	<b>622000</b>	<b>736000</b>	<b>879000</b>	<b>173000</b>	<b>188000</b>	<b>188000</b>	<b>194500</b>	<b>3. Public Security</b>
5. Licenses	40433	42000	48000	48000	22000	25780	25780	29000	4. Civil Defense
6. Fees	324181	310000	417300	440000	<b>1069024</b>	<b>1180351</b>	<b>1526144</b>	<b>1193428</b>	<b>c) Other Expenditures</b>
7. Revenues from Institutions	99949	91000	73600	86000	28972	28810	50218	38810	1. General Expenditures
8. Revenues from Governmental Services	19589	25000	45535	52000	63600	92459	83000	175000	2. Internal Loans Interests
9. Various Revenues	166280	154000	151565	253000	165447	161179	173000	175000	3. External Loans Interests (Accrual basis)
<b>c) Loans Installments Repayments</b>	<b>59664</b>	<b>10000</b>	<b>43000</b>	<b>30000</b>	<b>1796</b>	<b>2000</b>	<b>2000</b>	<b>2000</b>	<b>4. Contributions</b>
<b>2. Grants, including:</b>	<b>810900</b>	<b>1060000</b>	<b>520000</b>	<b>236000</b>	<b>632</b>	<b>650</b>	<b>650</b>	<b>1000</b>	<b>5. Refugees Welfare</b>
Transformation Program Grants	144200	56700	56700	68000	10057	15000	34000	22514	6. Emergency & Other Expenditures
					260000	310000	545000	125000	7. Fuel Subsidy
					0	0	57000	45000	8. Food Supplies Subsidy
<b>Total of Public Revenues</b>	<b>2949796</b>	<b>3060000</b>	<b>3025000</b>	<b>3000000</b>	<b>378473</b>	<b>414170</b>	<b>427000</b>	<b>475704</b>	<b>9. Pensions and Compensations</b>
					94331	88183	86376	70500	10. Institutions Subsidy
					46000	45000	45000	40000	11. Universities & Municipalities
					19716	22900	22900	22900	12. Academic Scholarships
					<b>775600</b>	<b>785000</b>	<b>632000</b>	<b>843000</b>	<b>2. Capital expenditures</b>
					491882	524215	445248	685535	1. Projects of Ministries & Governmental Departments
					112018	100000	94586	96000	2. Contributions to projects of Institutions
					171700	160785	92166	61465	3. Transformation Program Projects
<b>Budget Deficit Including Grants</b>	<b>152300</b>	<b>270000</b>	<b>480000</b>	<b>450000</b>					
<b>Budget Deficit Excluding Grants</b>	<b>963200</b>	<b>1330000</b>	<b>1000000</b>	<b>686000</b>					
<b>Total</b>	<b>3102096</b>	<b>3330000</b>	<b>3505000</b>	<b>3450000</b>	<b>3102095</b>	<b>3330000</b>	<b>3505000</b>	<b>3450000</b>	<b>Total</b>

Source: Ministry of Finance Budget Speech 2006, Government of Jordan.  
 Accessible at [http://www.mof.gov.jo/english/PDFs/2006/budget\\_speech06\\_en.pdf](http://www.mof.gov.jo/english/PDFs/2006/budget_speech06_en.pdf).  
 (Note: 1 JD = US\$1.4)

### Appendix D

#### MCC TCP Countries (as of FY 2007)

**Albania 2004**  
**Burkina Faso 2005**  
**Guyana 2005**  
**Indonesia 2006**  
**Jordan 2006**  
**Kenya 2004**  
**Kyrgyz Republic 2006**  
**Malawi 2005**  
**Mauritania 2008**  
**Moldova 2006**  
**Niger 2007**  
**Paraguay 2005**  
**Peru 2007**  
**Philippines 2006**  
**Rwanda 2007**  
**São Tomé and Príncipe 2004**  
**Tanzania 2004**  
**Timor-Leste 2004**  
**Uganda 2004**  
**Ukraine 2006**  
**Yemen 2004**  
**Zambia 2005**

Source: Millennium Challenge Corporation Website: [www.mcc.gov](http://www.mcc.gov)

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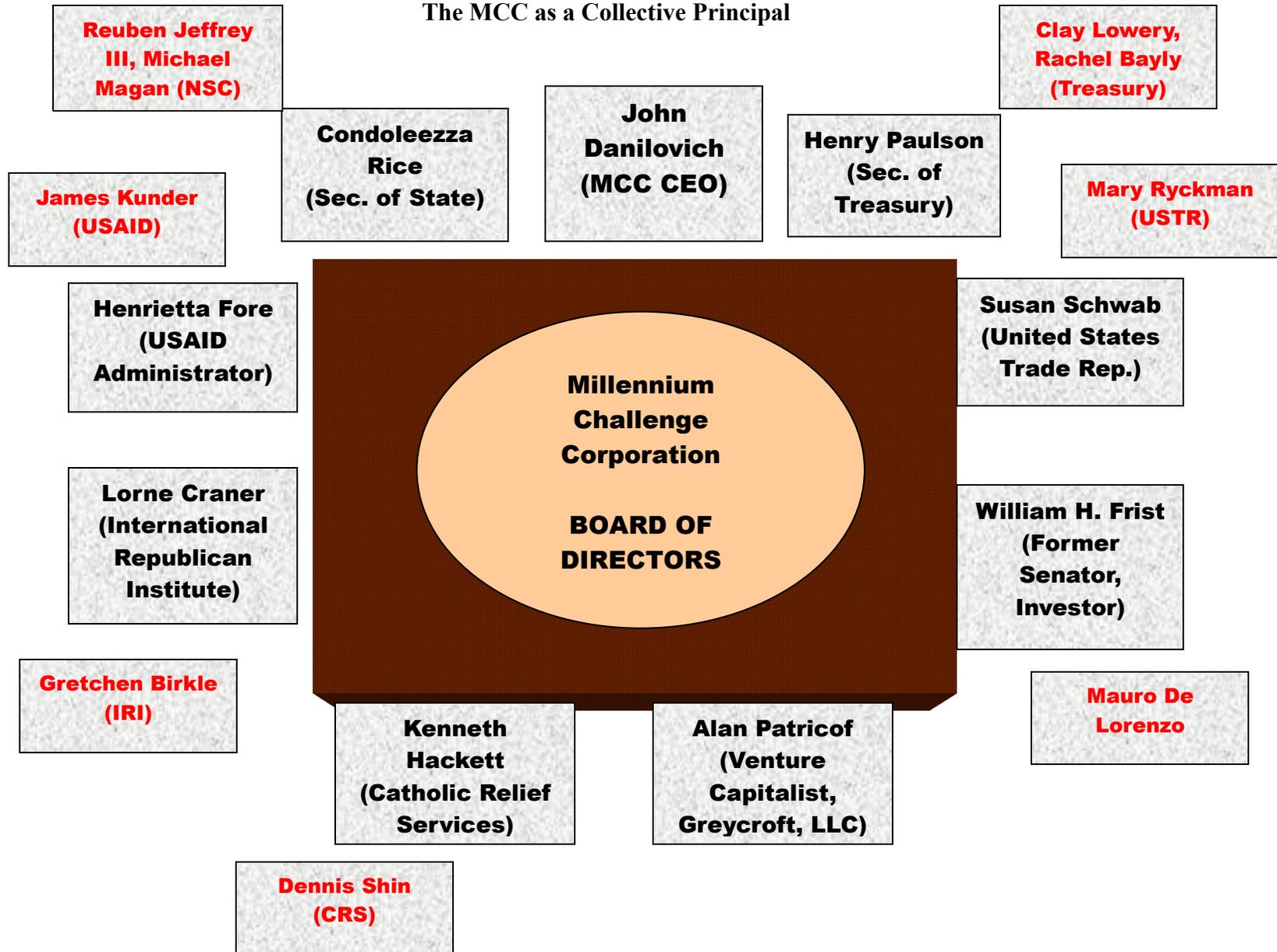
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Figure 3.1  
The MCC as a Collective Principal



**Table 4.1: Interviews in Jordan, 2006-2008**

	<i>Name</i>	<i>Office/Occupation</i>	<i>Interview(s) Date(s)</i>
<i>Jordanian Government (former and current)</i>	Jawad Anani	Former Foreign Minister; Economic Advisor	Nov.-Dec. 2006, Aug. 2007
	Ghaith Zureikat	Democracy Officer, Jordan Ministry of Planning	Nov. 2006
	Yusuf Mansur	Former Minister of Planning and International Cooperation	Dec. 2006
<i>Academics in Jordan</i>	Mustafa Hamameh	Strategic Studies Professor: Uni v. of Jordan; Adjunct: Georgetown	Sept. 2006
	Edward Saif	Author on Jordanian Economics, University of Jordan Professor	Oct. 2006
	Muhammed Al Khalil	Fulbright Scholar, Research Professor for the School of Intl Tr	Dec. 2006
<i>MCC, USAID, U.S. State Department workers</i>	Mara Galaty	USAID Democracy Officer - Planner of MCCTCP Grant	Nov. 2006
	George Kara'a	USAID Project Management Specialist - MCCTCP Grant	Nov. 2006
	Peter Malank	USAID Democracy Officer - Planner of MCCTCP Grant	Nov. 2006
	Stephen Carpenter	Chief of Party - ARD Inc., Developer of MCCTCP Grant	Nov. 2006, Aug. 2007, Feb 2008
	Bradley Parks	MCC Development Officer	Nov. 2007, Jan. 2008
	Miriam Schwedt	U.S. State Department, Jordan	Aug. 2007
<i>Aid Implementers</i>	Stephen Carpenter	(see above category)	
	Jan Karpowicz	Chief of Party: World Learning for Intl Development (NGO)	Nov. 2006
	Walter Kuencer	Chief of Party: DPK Consulting, MASAQ rule of Law Project	Nov. 2006
	Winkie Williamson	Strategic Advisor: Jordanian Fund for Human Development (N	Nov. 2006, Aug. 2007