

PARTNERING FOR PROSPERITY IN THE 21<sup>ST</sup> CENTURY: AN ANALYSIS OF  
LOCALLY LED AND MARKET-BASED APPROACHES TO GLOBAL  
DEVELOPMENT

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## **Abstract**

Despite major changes to the global economy, technology, and the developing world over the past few decades, the U.S. government's strategy on global development has not seen a major reassessment since the days of the Cold War. This is surprising given the United States' indispensable role as a leader in the international community and its historical role as a leader on global development initiatives. *Partnering for Prosperity in the 21<sup>st</sup> Century* examines the important role that domestic resource mobilization, trade facilitation, and economic growth-focused development programs play in the overall U.S. development strategy and calls for more emphasis on those concepts. These concepts are responsive to the dynamics of the global economy and could be employed in recognition of the limited domestic support in the United States for foreign assistance by supporting partner countries as they gain control of their own development priorities and harness the power of economic growth. In order for the United States to maintain its role as an effective leader in the global effort to combat poverty, these currently underinvested concepts must be at the forefront of U.S. efforts on development going forward.

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## Table of Acronyms

<i>Abbreviation</i>	<i>Definition</i>
ADB	Asian Development Bank
CA	Constraints Analysis
CDCS	Country Development Cooperative Strategy
DF4D	Domestic Finance For Development
DFID	UK's Department for International Development
DGII	Director General of Internal Taxes (El Salvador)
DRM	Domestic Resource Mobilization
ERR	Economic Rate of Return
GPH	Government of the Philippines
HRV	Hausmann, Rodrik, Velasco
IDB	Islamic Development Bank
ILO	UN's International Labor Organisation
IMF	International Monetary Fund
LPI	World Bank's Logistics Performance Index
MCC	Millennium Challenge Corporation
MFAN	Modernizing Foreign Assistance Network
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PFG	Partnership for Growth
SDGs	UN's Sustainable Development Goals
TFA	WTO Trade Facilitation Agreement
TPAR	Tax Policy and Administration Reform (El Salvador)
TPP	Trans-Pacific Partnership Free Trade Agreement
USAID	U.S. Agency for International Development
USDT	U.S. Department of Treasury
USG	U.S. Government
WTO	World Trade Organization

## Introduction

The integration of the global economy and advances in technology have brought remarkable progress to the developing world over the past few decades. Despite this progress, significant development challenges with important implications for global stability persist, as poverty and lack of economic opportunity create the conditions under which disease and violent extremism thrive.<sup>1</sup>

Supporters of stronger American leadership in global development face several challenges as populist political forces are increasingly critical of U.S. government investment abroad and funding for foreign assistance shrinks. This paper aims to address these challenges and reassess whether U.S. development policies are efficient, effective and currently suited for this era of limited resources for foreign assistance by properly leveraging the private sector.

Today, private capital flows into developing countries far exceed public capital flows in the form of donor government provided aid and loans, but U.S. development policy has undervalued this shift and failed to fully embrace the transformative development power of trade and investment.<sup>2</sup> The fundamental change in the nature of the global economy requires a development strategy that is responsive to these dynamics. This thesis explores approaches to development that leverage the strength of the private

<sup>1</sup> Research into the linkages between extreme poverty and conflict has grown considerably in the years since the September 11, 2001 attacks on the United States. Although there remains much debate regarding the extent to which extreme poverty drives international terrorism, it is clear that armed groups make economic appeals a foundation of their recruitment strategies. It is certainly the case that increased interest from U.S. policymakers in global development policy has been driven by national security interests post-September 11<sup>th</sup>. For further reading on the connection between poverty and violent extremism, I recommend *Rice, S., et. al., Confronting Poverty: Weak States and U.S. National Security*. Brookings Institution Press, 2010.

<sup>2</sup> Consensus for Development Reform (CDR). "Reform Policy Recommendations." <https://www.developmentreform.org/cdr-papers-events/consensus-for-development-reform-policy-recommendations>. Accessed November 2019.

sector and empower partner governments to gain more ownership over the development of their countries.

In 2015, the United Nations released its Sustainable Development Goals (SDGs), a set of ambitious targets in 30 key issue areas for global development to be met by the international community. These goals address all manner of issues important to human flourishing including health, food security, equality, and protecting the environment. The first goal set is to “end poverty in all its forms everywhere” and, in many ways, ending poverty is the unifying principle of the SDGs with the 29 remaining goals all in service of the first.<sup>3</sup>

The SDGs were released when global poverty was at the lowest level in history. In 1990, over 36 percent of the global population lived in extreme poverty, but by 2015 that percentage had reduced dramatically to 10 percent and over this same period mortality rates from diseases such as HIV/AIDS also reduced exponentially. Although economic inequality has been one of the largest drivers of policy debates and political movements in recent years, global inequality also saw a significant decline over the same period.<sup>4</sup>

Since the advent of the Marshall Plan, when significant resources were put into rebuilding Europe following World War Two, the United States has played a leading role in organizing the international community for the purpose of global development. Although development policies and intentions have changed since the post-war period,

<sup>3</sup> United Nations. “The Sustainable Development Agenda.” New York. (Accessed September 2019.) <https://www.un.org/sustainabledevelopment/development-agenda/>

<sup>4</sup> World Bank. “Decline of Global Extreme Poverty Continues but Slows.” September 19, 2018. Washington, DC. <https://www.worldbank.org/en/news/press-release/2018/09/19/decline-of-global-extreme-poverty-continues-but-has-slowed-world-bank>



there remains an important strategic rationale and moral case for the United States to continue to lead in this role. Despite this, many current U.S. development policies have not been refreshed since first being forged during the Kennedy Administration.

The first chapter focuses on how the United States works with partner countries to improve the social contract with their citizens by improving government revenues. The development concept central to this chapter is domestic resource mobilization (DRM), which has increasingly gained favor in recent years by donors and partner countries alike as evidenced by increased support from the International Monetary Fund (IMF), World Bank, the Organisation for Economic Co-operation and Development (OECD), regional development banks and the United Nations Development Programme (UNDP) in recent years and memorialized in the Addis Tax Initiative agreed to in 2015 at the multilateral Financing for Development Conference.

Donor support for DRM can bring about several positive development outcomes including improved governance and rule of law and an enhanced investment climate due to greater clarity for businesses on tax obligations and the reduction of corruption. Another key characteristic of DRM is its sustainability as partner countries gain greater access to revenues to address their own priorities. Indeed, the OECD has said that DRM “coupled with economic growth is the antidote to long term aid dependency.”<sup>5</sup> Despite this, DRM is just a small part of the overall U.S. development strategy.

After an exploration of the history and literature on DRM, the chapter turns its focus to how the U.S. Government has utilized the concept by exploring two significant

<sup>5</sup> OECD, “Taxation and Aid for DRM Aid: Helping or Harming Domestic Resource Mobilization in Africa.” Paris. <https://www.oecd.org/site/devaao10/44272298.pdf> (accessed September 2018.)

cases of U.S. investment in DRM in the Philippines and El Salvador. Using U.S. Government spending data from FY2009 to FY2016 and the underlying program design in each country, the chapter focuses on the efforts of three U.S. Government agencies that lead DRM development programming for the United States: USAID, the Millennium Challenge Corporation and the U.S. Department of Treasury's Office of Technical Assistance. The analysis finds that the elements that make for most effective U.S. DRM programs in these two countries are strong U.S. Government coordination and significant partner country commitment. Despite the long-term sustainable returns provided by U.S. investments in DRM, it still remains a small fraction of total U.S. foreign assistance.

The second chapter focuses on the relationship between trade facilitation and levels of commerce by assessing whether efforts to promote trade facilitation policies in Sub-Saharan Africa have had the desired result of increasing commerce and improving the business environment in the region. After setting the stage through an exploration of trade facilitation as a policy aim and some considerable multilateral steps taken in support of trade facilitation at the World Trade Organization (WTO), the chapter attempts to determine whether there is a relationship between pro-business reforms as tracked by the World Bank's *Doing Business* report and improvements in the business environment as measured by the Logistics Performance Index. The chapter finds that during the period of 2007-2018, there was a statistically significant relationship between overall Doing Business reforms and increases in the overall Logistics Performance Index (LPI) score but did not show that a focus on trade facilitation-specific reforms had a significant relationship with improvements in LPI in those trade facilitation specific categories. The general relationship between pro-business reforms undertaken by the governments of

Sub-Saharan Africa and improvements in the logistical performance in those countries suggests government commitment to reforms could indicate an improving business environment and the chapter concludes that more research is needed to attempt to better understand these linkages.

The third chapter focuses on a U.S. development agency relatively recently created, the Millennium Challenge Corporation (MCC), and its commitment to promoting economic growth in the developing world by addressing the greatest constraints to private sector investment in partner countries. The central focus of the chapter is the MCC Constraints Analysis that is intended to be foundational of any MCC relationship with a partner country. At the time of its opening in 2004, the MCC represented a novel approach to development and the Constraints Analysis was intended to galvanize the agency's approach to an economic growth-driven agenda. This chapter attempts to understand how well the MCC has adhered to this approach and whether there has been a degradation of the economic growth mission of the MCC in its fifteen years of operations by analyzing the MCC compacts that have resulted from Constraints Analyses and assessing whether they have produced projects aimed at addressing the constraints identified. Following a comparison of all MCC compacts to their Constraints Analyses, the compacts in the Philippines and Indonesia are reviewed as case studies.

This thesis considers three important development concepts that have been increasingly identified by economists and development experts as areas in which greater donor and partner country attention should be placed—domestic resource mobilization, trade facilitation and economic growth-focused programming—and considers the U.S. government's efforts to embrace these concepts. The expectation heading into this

assessment was to find that the U.S. government is underinvested and undercommitted to these concepts, particularly DRM and trade facilitation, which is an expectation that was supported by the analysis. The foundation is there for greater U.S. support for DRM programming and trade facilitation efforts, but the current level of resourcing for this type of programming shows that it is not currently a priority. This is despite the fact that the little support that has been provided for these concepts has proven to be a sustainable and effective investment.

On the concept of economic growth-focused development programming, the expectation was that MCC would have been found to adhere to its mission to addressing constraints to private sector growth because it was such an essential part of its ethos when created and as a relatively young agency the chances for mission drift were hopefully minimized. This was largely supported by the examination of the MCC compacts and projects, although it was also found that there had been times when the U.S. government lost track of what was supposed to be a single-tracked focus on economic growth in favor of some other tangentially related political priorities. That said, MCC is a relatively small agency when compared to others like USAID, so the question of the overall U.S. government commitment to tackling the obstacles to private sector investment and economic growth is still a question worth further examination.

The examination of these relatively novel concepts in development is significant because the global community is attempting to marshal resources and promote coordination through major multilateral efforts such as the previously mentioned SDGs, the Addis Tax Initiative and the WTO Trade Facilitation Agreement. U.S. leadership is often critical to the success of these types of global initiatives, but due to budget

constraints and some ideological challenges that global leadership from the United States is currently not a foregone conclusion. These particular concepts could appeal to the budget hawks who would like to support programs that leverage private sector resources or to the supporters of market-based approaches to addressing global poverty.

A brief note before the first chapter: there is a great deal of evidence to support the assertion that increased commerce and private sector investment is a critical element of successful global development policy, however it is not my intention to imply that it is the only element or most important element of effective development strategy, nor to discount the ongoing debate among policymakers, development practitioners, and economists regarding the proper role of encouraging greater private investment and the consequences of said investment. Additionally, there is a wealth of literature showing that the type of private sector activities undertaken in the developing world matter. For instance, heavy investment in the extractive industries can create an over-reliance a particular sector that can have negative consequences on governance, the environment and the diversification of the economy.<sup>6</sup> For the purposes of this thesis, I work from the view that inclusive and sustainable economic growth is a powerful driver of poverty alleviation--a view shared by the World Bank<sup>7</sup>, OECD<sup>8</sup>, and the UNDP<sup>9</sup>—and assesses its place in U.S. development strategy.

<sup>6</sup> Kolstad, Ivar. "Digging in the Dirt? Extractive industry FDI and Corruption." *Economics of Governance*. November 2013, Volume 14, Issue 4, pp 369-383.

<sup>7</sup> Ianchovichina, Elena and Susanna Lundstrom. "What is inclusive growth?" World Bank Group. Accessed November 2019. <http://siteresources.worldbank.org/EXTPREMNET/Resources/WhatIsIG.pdf?resourceurlname=WhatIsIG.pdf>

<sup>8</sup> OECD. "Opportunities for All: OECD Framework for Policy Action on Inclusive Growth." Paris. May 2018 (accessed November 2019.) <https://www.oecd.org/inclusive-growth/resources/Opportunities-for-all-OECD-Framework-for-policy-action-on-inclusive-growth.pdf>

<sup>9</sup> UNDP. "Inclusive sustainable growth." United Nations Development Programme. (Accessed November 2019) <https://www.undp.org/content/undp/en/home/2030-agenda-for-sustainable-development/prosperity/development-planning-and-inclusive-sustainable-growth.html>

## **Chapter 1 - Domestic Resource Mobilization**

Edmund Burke once observed, “revenue is the chief preoccupation of the state. Nay, more it is the state.”<sup>10</sup> Perhaps Burke overstates his case, but he understood the importance of revenue to the function and legitimacy of government. Nowhere is this nexus between revenue and state more evident than in the developing world, where many governments struggle to raise the revenue necessary to fund basic services for their citizens.

Without a stable source of revenue, government institutions weaken, infrastructure deteriorates, important social services diminish, and the safety of citizens is imperiled. These problems compound and can place a country on a dangerous trajectory. The widespread adoption of successful revenue raising systems in the developing world faces several challenges. Many governments lack the resources and capacity to build an effective tax administration regime, a challenge that contributes to the erosion of the social contract between the government and the governed. Public corruption, the inability of governments to provide basic services and the general misuse of public funds have all contributed to an inability, and at times unwillingness, of citizens in the developing world to pay taxes.

Income inequality in the developing world is also a key challenge to the generation of revenue. In many cases, economic elites are better equipped to avoid or evade taxes and the uncollected revenues from these elites can hamper the proper functioning of the state. On the other end of the income spectrum, the majority of citizens

<sup>10</sup> Dietz, FC. English Government Finance – 1485-1558. University of Illinois. Urbana, Illinois. p. 53

in the developing world participate in local informal economies, presenting a whole different set of challenges to tax collectors.

Addressing this resource and technical capacity gap is often the aim of development programs classified under the heading of Domestic Resource Mobilization (DRM). DRM as a development concept has been contemplated since the mid-twentieth century, but has gained favor in recent years, culminating with the Third International Conference on Financing for Development held in Addis Ababa, Ethiopia, in July 2015 which resulted in the Addis Tax Initiative, in which donor countries pledged to double their support for DRM programming and partner countries agreed to step up efforts to collect and spend their resources.

The Addis Tax Initiative represents a collective recognition of shifting capital flows into the developing world and the increasing ability of partner countries to fund development, a trend that must continue to meet the ambitious Sustainable Development Goals (SDGs). According to the International Monetary Fund (IMF), only 31 countries worldwide are below the 20 percent revenue-to-GDP ratio target set by the Addis Tax Initiative and only nine are below 15 percent: Central African Republic, Nigeria, Guatemala, Bangladesh, Sudan, Iran, Sierra Leone, Costa Rica and the Dominican Republic.<sup>11</sup>

In addition to impacting issues like governance and inequality, inadequate government revenues also can impede economic growth in the developing world. A recent study of macroeconomic data from Tanzania for the period of 1996-2015 found a

<sup>11</sup> Kenny, Charles. "Let's Mobilize the Right Domestic Resources for Development." Center for Global Development. April 16, 2015 (accessed January 2018.): <https://www.cgdev.org/blog/lets-mobilize-right-domestic-resources-development>

significant positive long-term effect of DRM efforts on economic growth, largely due to the improvement in Tanzania's ability to finance its own development priorities.<sup>12</sup>

As consensus builds among donors and partner countries on the importance of DRM to international development and as policymakers in the United States consider options to advance the goals on DRM set by the Addis Tax Initiative, it is important to consider the effectiveness of U.S. DRM efforts in the developing world to date.

In this chapter, I explore two cases of significant U.S. engagement on DRM in El Salvador and the Philippines by focusing on the design and implementation of DRM programs of the U.S. Agency for International Development (USAID), the Millennium Challenge Corporation (MCC) and the U.S. Department of Treasury (USDT). These agencies are responsible for funding, implementing and coordinating the vast majority of U.S. government efforts in DRM, so an analysis of the program design, resourcing and the level of interagency coordination in each country will be useful as we also determine whether DRM efforts have been successful and sustainable in each country.

Many previous analyses on the impact of U.S. DRM efforts, some provided by the relevant U.S. agencies themselves, have primarily focused on funding as the measurement of U.S. commitment on DRM. However, many of these analyses focus on the success of a particular program and the funding associated with that discrete program which is typically managed by one U.S. government agency. For this chapter, I examined all U.S. Official Development Assistance (ODA) to El Salvador and Philippines over the period of Fiscal Years 2009-2016 to determine the extent to which DRM was prioritized

<sup>12</sup> Cyril, Chimilila, "Domestic Resource Mobilization and Long Term Economic Growth in Tanzania." African Journal of Economic Review. African Journal of Economic Review, vol. 6(1). January 2018.



by the U.S. government in each country during that period. For these analyses, I used USAID's Foreign Aid Explorer to determine topline levels of ODA delivered to each country overall and by agency. I then used Foreign Aid Explorer to examine the funding data at a programmatic level, to determine which funding was specifically supporting DRM efforts in country.

Importantly, these funding analyses are just a snapshot during the 8-year period of the Obama Administration and do not provide the context of DRM efforts in the years before during the Bush Administration and years after during the Trump Administration. The funding analyses focus on this period for several reasons, most of which are practical matters related to data availability-- data for FY16-17 has not yet been fully reported and pre-2009 data lacked the reporting requirements that allow for a more detailed programmatic analysis.

In order to provide more context to the overall approach of the U.S. government in both countries, I examine U.S. government strategies and documents such as the USAID Country Development Cooperative Strategies (CDCS) and the MCC Compacts themselves.

By examining these two contexts of significant U.S. government investment in DRM programs in El Salvador and the Philippines, I will assess the effectiveness of the programs and explore the factors that contributed to their success. In both cases, I examine the factors that may have impacted the effectiveness of U.S. supported DRM programming.

I will be most interested in the policy decisions of the U.S. Government and how the program was designed and fit into the United States' overall strategic goals for the

relationship with the country hosting the program. I will also assess the conditions on the ground in the host country and the commitment of the government to enacting reforms.

I suspect that the most significant success will be programs that had a narrow focus on tax policy and capacity building for revenue collection and programs that have a broader scope or are sector-specific, will have a less sustainable impact. I further expect to find a positive relation between general economic liberalization efforts in a country and the country's ability to raise its own revenue.

### **Growing Interest in DRM**

Before jumping into the case studies, it is helpful to consider the context in which DRM as a development discipline exists as the level of interest in DRM has varied over the past few decades. While writing on the Republic of Korea's own DRM efforts, Yusuf and Peters explained that although savings behavior was once a central tenet of economic development in the developing world, interest in the subject of domestic savings had waned by the mid-1970's largely due to the sudden availability of foreign capital, primarily due to oil revenues and spending related to the influence peddling of the Cold War.<sup>13</sup> As a result of the increased interest in the resources of the developing world, countries once seen as risks by financial institutions are viewed more favorably, and resources in those countries became less tied to the saving behaviors of its citizens and governments. This decreased reliance on domestic resources also led to a reduction in the analysis and study of savings behaviors in the developing world. This, coupled with an already existing lack of data, ensured that research in the field of DRM atrophied.

<sup>13</sup> Yusuf and Peters, "Savings Behavior and Its Implications for Domestic Resource Mobilization: the Case of the Republic of Korea." World Bank Staff Working Papers Number 628. World Bank. Washington, DC. April 16, 1984. (pg. 1)

The Global Financial Crisis revealed the “futility” of dependence on aid for sustained development and countries in the developing world and incentivized governments to look internally for sources of funding.<sup>14</sup> Aryeety warned that the global recession would further degrade the already challenged efforts to develop domestic resources, even though the access to foreign capital would be more difficult.<sup>15</sup>

Serieux wrote about revenue challenges in Africa and lamented that since 1980, on average 35 percent of the region’s investment levels were funded by foreign savings, and these foreign investments have been mostly in the form of official development assistance (ODA) rather than private investment.<sup>16</sup> Serieux writes that if DRM efforts do not improve in sub-Saharan Africa, it will further institutionalize and perpetuate low savings rates. Serieux builds upon the work of McKinnon<sup>17</sup> and Shaw<sup>18</sup> to argue that the liberalization of financial programs in Africa is a vital element to improved DRM.

In recent years, development experts have increasingly called on developing countries to improve their efforts on domestic resource mobilization. Ben Leo of the Center for Global Development argues that despite Nigeria’s rise to middle-income status and its GDP of nearly \$500 billion in 2014, it is not doing nearly enough to mobilize its resources.<sup>19</sup> Leo says that an additional \$67 billion could have been raised in 2013 if Nigerian revenue ratios matched that of fellow sub-Saharan Africa countries. Nigeria’s revenue-to-GDP ratio that year was 10 percent; only the Central African Republic had a

<sup>14</sup> Ogunleye, Eric Kehinde, and Desire Adebimpe Fashina. “The Imperatives for Domestic Resource Mobilization for Sustained Post-Crisis Recovery and Growth in Sub-Saharan Africa.” African Development Bank. 2010.

<sup>15</sup> Aryeety, Ernest. “The Global Financial Crisis and Domestic Resource Mobilization in Africa.” African Development Bank. 2009.

<sup>16</sup> Serieux, John. “Financial Liberalization and Domestic Resource Mobilization in Africa: an Assessment.” International Poverty Centre, April 2008. Published by UNDP. <http://www.ipc-undp.org/pub/IPCWorkingPaper45.pdf>

<sup>17</sup> McKinnon, R.I. (1973). *Money and Capital in Economic Development*. Washington D.C.: The Brookings Institution

<sup>18</sup> Shaw, E.S. (1973). *Financial Deepening in Economic Development*. New York: Oxford University Press.

<sup>19</sup> Leo, Ben. “Is It Time to End the Nigeria Charade?” Center for Global Development (2014.) <http://www.cgdev.org/blog/it-time-end-nigeria-aid-charade> (Accessed Apr. 20, 2016)

lower ratio. According to Leo, the \$67 billion that could have been raised represented 33 times the total amount of official development assistance provided by donors during the same period.

Johnson identifies six constraints that limit the ability for DRM: low disposable incomes, pervasive corruption, underdeveloped financial systems, tax policy weaknesses, legal system inadequacies, little support of the population in addressing governance.<sup>20</sup> These issues are general development challenges and solving them are components of various development programs.

Although this chapter will focus on development programs focused on tax administration and revenue collection, there are also those that argue that increased trade liberalization and tariff reduction have created difficulties for governments seeking to raise capital. In many cases, these governments were largely dependent on the revenues generated by their ports of entry and customs facilities. However, Edwards and Lederman counter that this same trade liberalization that has shifted countries away from tariff collection as a revenue driver has afforded opportunities for economic growth and tax base broadening in Chile that would not have been available before the age of globalization and the WTO.<sup>21</sup> Kowalski notes the benefits to the developing world for reducing tariffs, but that these trade reforms must be complementary to significant tax reform.<sup>22</sup> There are challenges facing governments looking to strike the correct balance

<sup>20</sup> Johnson, O.E.G. *Economic Diversification and Growth in Africa: Critical Policy Making Issues*. Springer International Publishing: Imprint: Palgrave Macmillan, 2016.

<sup>21</sup> Edwards, Sebastian, and Daniel Lederman. "The Political Economy of Unilateral Trade Liberalization: The Case of Chile." April 1998. NBER Working Paper Series. Working Paper 6510. Cambridge.

<sup>22</sup> Kowalski, Przemyslaw. "Impact of Changes in Tariffs on Developing Countries' Government Revenue." OECD Trade Policy Working Papers. <https://www.gtappagecon.purdue.edu/resources/download/2115.pdf>

on tax and tariff policies that both promote economic growth and allow for revenue generation.

There are serious economic, societal and governance consequences that either result from or are exacerbated by these challenges to revenue collection. According to some, the difficulties facing tax collection have led to an over-reliance on revenue generated by the extractive sector (oil, gas, minerals, etc.) This reliance on sectors with volatile pricing has often led to policies in the developing world that deter the diversification of economies.<sup>23</sup> In addition, the competitive race for natural resources needed to fuel the rapid growth of countries such as China has increased levels of corruption among energy and commerce ministry officials and has not done much to address local unemployment issues as many foreign firms bring in their own workers for projects.

### **El Salvador**

In its efforts to promote a DRM agenda following the adoption of the Addis Tax Initiative in July 2015, the Obama Administration often touted to the success of a Bush Administration initiative in El Salvador focused on tax collection in which a \$5 million investment made in 2004 and matched by El Salvador resulted in a revenue increase of over \$2 billion since 2005.<sup>24</sup> A review of the details of the program and the political and economic environment in which it was designed and implemented leads to questions over

<sup>23</sup> Dyna, Heng and Ngo Sothat. "Extractive Industries Revenue Management: A Tale of Six Countries. Research Report 4." Cambodian Economic Association. April 2013.

<sup>24</sup> USAID. "El Salvador Tax Reform Case Study." United States Agency for International Development. Washington. [https://www.usaid.gov/sites/default/files/documents/1865/El%20Salvador%20Tax%20Reform%20Case%20Study\\_fall%202014.pdf](https://www.usaid.gov/sites/default/files/documents/1865/El%20Salvador%20Tax%20Reform%20Case%20Study_fall%202014.pdf)

some of USAID's bolder claims about its impact, but this program has been unquestionably successful and worthy of further examination.

Emerging from a period of civil war, El Salvador, with the encouragement of the United States and other donors, promulgated an ambitious series of reforms in the 1990s and adopted a new constitution. Many of these reforms were aimed at rebuilding a government and society torn apart by war in the 1980s and included efforts to strengthen the judiciary, demilitarize the police, liberalize trade and the financial services sector, privatization of the energy and communications industry and modernization of the tax system.<sup>25</sup>

Despite the commitment to this reform agenda, El Salvador was unable to achieve the sustained growth attained by fellow Latin American reformer, Chile. After an initial post-conflict recovery, El Salvador's per capita income remained stagnant throughout the late 1990's and 2000s. Many factors contributed to the stagnant growth during this period, including natural disasters, a collapse in the price of coffee, global recession and lower levels of investment in the economy from domestic and foreign sources.

Many traditional explanations do not account for the lack of investment in El Salvador in the late 1990's and early 2000's. Many of the post-war reforms of El Salvador were successful: corruption levels trended downward, trade policies liberalized, and tax rates became more competitive. Despite this, El Salvador's economic growth and government revenues plateaued during this period and El Salvador revenues as a

<sup>25</sup> Hausmann, Ricardo, and Dani Rodrik. "Self-Discovery in a Development Strategy for El Salvador." *Economia*. Fall 2005. [https://growthlab.cid.harvard.edu/files/growthlab/files/discovering-el\\_salvador-production-potential.pdf](https://growthlab.cid.harvard.edu/files/growthlab/files/discovering-el_salvador-production-potential.pdf) (accessed August 3, 2017).

percentage of GDP and government spending were far lower than comparable countries by the mid-2000s.

In this environment, the United States and El Salvador entered into an agreement in 2004 on a program that targeted lackluster government revenue flows by broadening the tax base and improving tax collection. In 2004, the USAID Mission to El Salvador entered into an agreement with the Director General of Internal Taxes (DGII), El Salvador's national tax administration to implement the Tax Policy and Administration Reform (TPAR) project, a five-year USAID program that would modernize and improve El Salvador's tax administration with the aim of generating more revenue for El Salvador without raising tax rates.<sup>26</sup> Importantly, the Government of El Salvador agreed to match the USAID investment of \$5 million for the project.

According to Development Alternatives Incorporated (DAI), the development contractor USAID selected to implement TPAR; this program helped El Salvador increase tax-to-GDP ratio from 12.2 percent in 2004 to 14.1 percent in 2007 and captured an additional \$38 million in revenues through a new compliance regime and improvements to DGII's technology.<sup>27</sup>

In addition to the investments in technology at DGII, TPAR focused on improving communication between the El Salvador tax officials and taxpayers. A call center was created to guide taxpayers, an ombudsman office was established help develop trust between Salvadorans and their tax administration, and tax auditing was

<sup>26</sup> Geraldo, Enrique. "Domestic Resource Mobilization Takes Root in El Salvador ... and Beyond?" DAI. <https://dai-global-developments.com/articles/long-term-fiscal-reform-takes-root-in-el-salvador-and-elsewhere/> 2016 (Accessed Jan. 2018)

<sup>27</sup> Ibid

made more efficient. In 2010, DGII used its revamped auditing procedures to find over \$100 million in underreported taxes, compared to \$50 million from audits for all of 2009.<sup>28</sup>

New programs and initiatives were soon introduced to build upon the success of this initial partnership between USAID and El Salvador. In 2012, USAID launched Domestic Finance for Development (DF4D), a \$2-million DRM program focused on El Salvador's municipalities. DF4D was one of many economic growth focused initiatives announced following U.S. President Barack Obama's March 2011 visit to El Salvador, when he pledged to strengthen the bilateral relationship through his administration's Partnership for Growth (PFG) initiative.<sup>29</sup>

In the CDCS for El Salvador developed for 2013-2017, economic growth remained a development priority for the United States but was placed below concerns over crime and insecurity. Nevertheless, USAID DRM efforts remained in the CDCS as a part of Development Objective 2 in El Salvador, mostly driven under the auspices of PFG.

MCC has entered into two compacts with El Salvador, the first (2007-2012) was focused on development in the impoverished Northern Zone of the country and worked mostly on improving the infrastructure in the region. The second and current compact was signed in 2014 and focuses on improving the investment climate in El Salvador.

<sup>28</sup> USAID. "DRM – El Salvador Tax Reform Boosts Revenues for Development." [https://www.usaid.gov/sites/default/files/documents/1865/El%20Salvador%20Tax%20Reform%20Case%20Study\\_fall%202014.pdf](https://www.usaid.gov/sites/default/files/documents/1865/El%20Salvador%20Tax%20Reform%20Case%20Study_fall%202014.pdf)

<sup>29</sup> USAID. Country Development Cooperation Strategy for El Salvador 2013-2017. [http://pdf.usaid.gov/pdf\\_docs/pdacy241.pdf](http://pdf.usaid.gov/pdf_docs/pdacy241.pdf). Accessed January 2018.



Although making El Salvador more attractive to investment will certainly help raise revenues, the compact itself does not work on DRM. USAID is the clear driver of U.S. government efforts on DRM in El Salvador, which the funding analysis in Table 1.1 clearly shows.

**Table 1.1: U.S. Official Development Assistance (ODA) for El Salvador: FY09-16**

El Salvador	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
<b>Total ODA</b>	<b>\$41.6M</b>	<b>\$61.5M</b>	<b>\$81.3M</b>	<b>\$54.2M</b>	<b>\$65.1M</b>	<b>\$81.4M</b>	<b>\$326.8M</b>	<b>\$64.6M</b>
USAID	\$27.9M	\$33.2M	\$65.1M	\$39.4M	\$63.9M	\$64M	\$50.6M	\$59M
DRM Programs	\$503,928	\$981,627	\$2,362,150	\$1,359,000	\$1,931,000	\$1,490,000	\$1,269,390	\$2,359,454
MCC	\$1.7M	0	\$1.2M	\$1.8M	\$10.7M	\$12.1M	\$272.4M	\$2.3M
DRM Programs	0	0	0	0	0	0	0	0
USDT	n/a	n/a	n/a	n/a	\$0.8M	\$1.4M	\$0.5M	\$0.6M
DRM Programs	0	\$315,747	\$318,370	\$446,762	\$785,408	\$1,181,420	\$374,081	\$578,782
<b>Total DRM</b>	<b>\$503,928</b>	<b>\$1,297,374</b>	<b>\$2,680,520</b>	<b>\$1,805,762</b>	<b>\$2,716,408</b>	<b>\$2,671,420</b>	<b>\$1,643,471</b>	<b>\$2,938,236</b>

Source: USAID Foreign Aid Explorer; Data incomplete for FY17 and FY18; DRM data from programmatic reports found on USAID Foreign Aid Explorer.

The funding analysis tracks closely with the CDCS and found that for FY09-16, USG spent on average \$97,062,500 annually on ODA in El Salvador, of which \$2,032,140 was spent annually on DRM programming. This is approximately 2.09% of total U.S. ODA spent in El Salvador over the period of FY09-16, well above the percentage of funding spent on DRM across all USG programs globally, which the Modernizing Foreign Assistance Network (MFAN) estimates is less than .2%.<sup>30</sup>

The majority of the spending on DRM over the period was through USAID, which supported DRM programming at a rate of \$1,532,069 a year on an overall USAID

<sup>30</sup> Modernizing Foreign Assistance Network (MFAN). Principles of Public Sector Domestic Resource Mobilization in Developing Countries. <http://www.modernizeaid.net/wp-content/uploads/2018/04/MFAN-DRM-principles-4-19-18.pdf>

budget in El Salvador of \$50.4 million. During the same period, Treasury spent \$500,071 a year in support of DRM programming in El Salvador, but on a much more modest overall budget that averaged \$825,000 over FY13-16. While the MCC had a compact with El Salvador during this time, it was focused on infrastructure and education and not on DRM.

The USAID funding is in support of sustaining the DRM projects in El Salvador referenced earlier and shows that DRM remains an important element of USAID's work in the country, but not the priority as other sectors such as agriculture and health receive greater levels of funding. Interestingly, the funding for DRM provided by USDT, while slightly below the level of funding provided by USAID, represents a vast majority of USDT assistance to El Salvador, showing a clear prioritization of DRM as far as their work in the country is concerned.

In 2009, a new government took office in El Salvador with the intention of raising tax revenue and directing those resources toward tackling development challenges facing its people. In its first four years, the new government boosted revenue 12.6 to 15.4 percent of GDP and the commitment of the government of El Salvador to focusing on effective revenue collection continues today.

An initial USAID investment of \$5 million ultimately led to policy and structural changes that helped raise El Salvador's revenues by \$40 million annually. El Salvador has been a willing and enthusiastic partner since the beginning, as evidenced by the matching funds provided by El Salvador at the outset of the DRM partnership with USAID. This program has been extended or built upon in multiple iterations since 2004 and is currently slated to continue through 2022.

## **Philippines**

Despite a growing economy over past several decades, the Philippines has not experienced commensurate growth in incomes or a significant reduction in poverty, and approximately 21.6 percent of Filipinos live below the international poverty level.<sup>31</sup> There are several significant challenges to sustained, inclusive economic growth in the Philippines, including ineffective governance, the weak rule of law, an uncertain regulatory environment, corruption, poor health and social services, and inadequate infrastructure.

In recent years, the U.S. development strategy in the Philippines has prioritized control of corruption as a key to helping promote the economic growth, and many of these anti-corruption programs have either had a direct or indirect connection to revenue collection efforts of the Philippines. In contrast to El Salvador, where the U.S. Government's efforts on DRM were entirely led and coordinated by USAID, DRM efforts in the Philippines are evident in initiatives of USAID and the Millennium Challenge Corporation (MCC).

In July 2006, the Philippines and the United States signed an agreement to begin an MCC Threshold Program aimed at increasing revenue by improving the ability of revenue collection agencies to deter tax evasion, increase compliance and reduce corruption. It also bolstered the Office of the Ombudsman at the Bureau of Internal Revenue to help root out corruption. The Philippines was not eligible for a full MCC

<sup>31</sup> World Bank. "Philippines' Poverty Rate Declines; More Well-Paying Jobs and Opportunities Needed." Press Release. World Bank Group. Washington. May 30, 2018.

compact at the time, due to failing the Control of Corruption indicator in the Ruling Justly category of MCC eligibility criteria.

At \$20.7 million, the Threshold Program was meant to bridge the Philippines to a larger, more comprehensive MCC Compact. Administered by USAID, the program was a success and could boast achievements such as a 16.5 percent increase in corporate income tax returns filed, 3,000 staff trained on anticorruption and anti-tax evasion techniques, and a 55 percent conviction rate against high-ranking public officials.<sup>32</sup> Most importantly, during the implementation of the threshold program, the Philippines became eligible for a full MCC Compact aimed at addressing constraints to economic growth in the Philippines identified by a 2007 report published by the Asian Development Bank.<sup>33</sup> Signed in September 2010, the Philippines Compact was a five-year, \$434 million program that focused on infrastructure, public participation in economic development activities, and revenue collection. \$54.3 million of the Compact focused on revenue activities in a program known as the Revenue Administration Reform Project, which was explicitly designed to build off of the progress made by the MCC Threshold Program and focused on modernizing the administration Philippines Bureau of Internal Revenue through IT upgrades and greater automation of the auditing process. In addition, the MCC supported a public awareness campaign to help build trust in the BIR in a bid to increase tax compliance and strengthen the social contract.

The USDT's Office of Technical Assistance, a small office established in 1990 to assist economic transition in Eastern Europe following the fall of the Berlin Wall, is

<sup>32</sup> MCC. "Where We Work: Philippines Threshold Program." Millennium Challenge Corporation. Washington. Accessed June 2019. <https://www.mcc.gov/where-we-work/program/philippines-threshold-program>

<sup>33</sup> MCC. "Where We Work: Philippines Compact." Millennium Challenge Corporation. Accessed June 2019. <https://www.mcc.gov/where-we-work/program/philippines-compact>

aiding the Government of the Philippines as it implements a new payroll and human resources system that is expected to save 10% of payroll costs annually.<sup>34</sup>

For its part, USAID is implementing a separate \$13 million project, under the auspices of the Partnership for Growth initiative, aimed at revamping the internal workings of the Philippines Department of Finance. According to USAID's Country Development Coordination Strategy, Development Objective 1 for the Philippines is to enhance economic competitiveness, which is hampered by "weak governance and a narrow fiscal space."<sup>35</sup> USAID recognized that the Government of Philippines' shortcomings on tax administration, tax policy (too many exemptions, incentives and similar revenue reducers) and rampant corruption had resulted in chronic underinvestment in areas like health and infrastructure.

In coordination with the MCC, USAID's program aimed to address insufficient revenue generation, reduce tax leakages, and improve expenditure management of GPH agencies. USAID provided support to the GPH in undertaking fiscal policy reforms to broaden the tax base and expand tax collection and support measures to improve the allocation and utilization of the budget. In addition, USAID provided funding to non-governmental institutions to strengthen fiscal transparency and third-party oversight of the national budget.

<sup>34</sup> Dunning, Casey. "Time for US to Ramp Up Efforts on Domestic Resource Mobilization." Center for Global Development. <https://www.cgdev.org/blog/time-us-ramp-efforts-domestic-resource-mobilization>. April 21, 2015.

<sup>35</sup> USAID. "Country Development Cooperation Strategy for the Philippines 2013-2018." Accessed January 2018. [https://www.usaid.gov/sites/default/files/documents/1861/CDCS\\_Philippines\\_Public\\_Version\\_2013-2018\\_as\\_of\\_June\\_2017.pdf](https://www.usaid.gov/sites/default/files/documents/1861/CDCS_Philippines_Public_Version_2013-2018_as_of_June_2017.pdf)

**Table 1.2: U.S. Official Development Assistance (ODA) for Philippines: FY09-16**

Philippines	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
<b>Total ODA</b>	<b>\$123.7M</b>	<b>\$164.7M</b>	<b>\$571.7M</b>	<b>\$177.3M</b>	<b>\$181.2M</b>	<b>\$303.2M</b>	<b>\$155.3M</b>	<b>\$136.8M</b>
USAID	\$79.6M	\$93.9M	\$114.8M	\$136.2M	\$130.1M	\$216.4M	\$129.8M	\$120M
DRM Programming	\$1,245,317	\$200,000	\$1,580,996	\$94,669	\$12,352,279	\$8,749,813	\$7,352,035	\$5,836,691
MCC	\$1.3M	\$27.1M	\$415.6M	\$3.2M	\$3M	\$0.8M	\$1.7M	\$1.8M
DRM Programming	\$598,644	\$7,300,000	\$44,325,000	\$2,675,000	0	0	0	0
USDT	\$0.3M	0	0	\$0.1M	\$0.4M	\$0.5M	\$1.1M	\$1.6M
DRM Programming	\$29,557	0	0	\$92,996	\$376,554	\$469,946	\$746,864	\$612,869
<b>Total DRM</b>	<b>\$1,873,518</b>	<b>\$7,500,000</b>	<b>\$45,905,996</b>	<b>\$2,862,665</b>	<b>\$12,728,833</b>	<b>\$9,219,759</b>	<b>\$8,098,899</b>	<b>\$6,449,560</b>

Source: USAID Foreign Aid Explorer; Data incomplete for FY17 and FY18; DRM data from programmatic reports found on USAID Foreign Aid Explorer.

The funding analysis in Table 1.2 found that for FY09-16, USG spent on average \$226,737,500 annually on ODA in Philippines, of which \$11,829,904 was spent annually on DRM programming. This is approximately 5.22% of total U.S. ODA spent in Philippines over the period of FY09-16, significantly above the .2% of funding spent on DRM across all USG programs globally. Both in real terms and as a percentage of the overall ODA, the DRM funding in Philippines is among the highest across all U.S. partner countries.

The majority of the spending on DRM over the period was through MCC, which as noted earlier implemented the Revenue Administration Reform Project as part of its 5-year compact which provided funding for DRM programming at its peak in FY11 at \$44,325,000, before closing out and providing no funding from FY13-FY16.

As the MCC funding reduced, the USAID funding increased, peaking at \$12,352,279 in FY13 and averaging \$4,676,475 throughout the FY09-16 period. During

this same period following the MCC reduction, Treasury increased its funding for DRM at an average of \$551,558 a year from FY13-16, following years of little to no funding for DRM efforts in the Philippines. This suggests support for sustaining DRM efforts following the close out of the MCC Philippines Compact.

A March 2017 ex-post evaluation of the MCC Revenue Administration and Reform Project found that the project was modestly successful, particularly in improving Filipino taxpayers' understanding of their tax obligations and their trust in the Bureau of Internal Revenue, with perceptions of corruption at the agency decreasing from 52% to 46%.<sup>36</sup> In addition, the evaluation found that MCC's partnership with IMF on technical assistance for this project proved successful and a model for future MCC compacts.<sup>37</sup>

Despite the success of this MCC revenue administration program and the overall multi-agency effort of the U.S. government in the Philippines, there does not appear to be any sustained improvement to domestic resource mobilization in the country. In 2014, the Philippines had one of the lowest VAT revenue ratios (VRRs), a measure of revenue capture, in Asia, and total tax revenue as a percentage of GDP has just slightly improved from 15.8% in 1995 to 17% in 2015.<sup>38</sup>

## **Chapter 1 Conclusion**

Although El Salvador and the Philippines share similar challenges, particularly in terms of corruption and the rule of law, there are significant differences between the

<sup>36</sup> MCC. "Measuring Results of the Philippines Revenue Administration and Reform Project." Millennium Challenge Corporation. March 2017 (accessed September 2019.) <https://www.mcc.gov/resources/doc/summary-measuring-results-of-the-philippines-revenue-administration-and-ref>

<sup>37</sup> *ibid*

<sup>38</sup> OECD. "Falls in tax revenue weaken domestic resource mobilization in developing Asia" <http://www.oecd.org/countries/philippines/revenue-statistics-in-asia-2017-falls-in-tax-revenue-weaken-domestic-resource-mobilisation-in-developing-asia.htm>. July 20, 2017.

countries, not the least of which is scale, as the Philippines has a population of 103.3 million, while El Salvador's population is 6.3 million. The U.S. DRM strategy in both of these countries was developed with these differences in mind and are likely responsible for many of the differences, particularly in the absence of an overarching U.S. government strategy on DRM.

In terms of the U.S. government strategy in each country, DRM efforts in El Salvador have been clearly concentrated through USAID, with Treasury providing technical support. In the Philippines, MCC was the locus of a highly resourced and relatively short-term effort on DRM that was later sustained with less intensity by USAID programming. For its part, USDT appears to have increased its involvement in DRM alongside USAID's engagement in both cases. The coordination between USAID and USDT and the lack of coordination between MCC and USDT are both issues worth studying to see if it appears in other country contexts.

With these differences in mind, another key element of El Salvador's success may have been its own significant investment into the programming. The initial USAID program began with a \$5 million U.S. government investment that was matched by the Government of El Salvador. Adjusted by 2006 GDP figures, El Salvador's investment represented an equivalent U.S. government investment of \$3.74 billion.

The Philippines has not made similar sized investments into revamping its own tax administration systems and the last two administrations (Aquino and Duterte) have struggled with attempts to move tax regime reforms through Congress. Institutional resistance from those that have benefited from the status quo and the difficulties



associated with a system of revenue collection with stronger organization on the state level rather than federal level has stymied efforts to promote these internal reforms.<sup>39</sup>

While U.S. programs in both countries have had a level of success, the USAID program in El Salvador has been the highest performer due to a number of factors, but perhaps most importantly the high-level of El Salvador's own financial commitment to the program. The high performance of this program has made it the case study for USAID efforts to promote more sustained engagement on DRM throughout the world.

In Fiscal Year 2016, the United States spent nearly \$34 billion in official development assistance but approximately \$35 million on DRM. This reflects a somewhat consistent approach and commitment to DRM as a development objective during both the Bush and Obama Administrations. Both administrations expressed interest in the development benefits associated with DRM programming, but the DRM emphasis appeared to be driven at a country level and varied mission to mission. Both administrations lacked a clear overarching strategy to prioritize DRM as a critical driver of development in the way Bush prioritized global health or Obama sustainable agricultural development. During both administrations, there were those in leadership at USAID and Treasury who attempted to drive more resources and attention to DRM, but ultimately never got the backing necessary to make it a pillar of U.S. development policy.

In the last few years of the Obama Administration, USAID and the U.S. Treasury Department increasingly engaged host governments and civil society, as well as partners in Congress, on the concept of DRM. As the leaders of these efforts, USAID Associate

<sup>39</sup> De Vera, Ben. "Finance chief: Tax regime under federal gov't seen 'very challenging'" Philippine Daily Inquirer. 23 January 2018. <http://business.inquirer.net/244652/tax-administration-revenue-finance-dominguez-tax-reform-package-economy-federal-government>

Administrator Eric Postel and Deputy Assistant Secretary of Treasury Larry McDonald often touted the success of the DRM program in El Salvador in discussions with Congress in support of a DRM pilot program.<sup>40</sup> For DRM advocates, this pilot program was a promising step, but it's funding was limited and came with restrictions that limited flexibility.<sup>41</sup>

Despite the Trump Administration's efforts deprioritize global development (the Administration's Fiscal Year 2018 Budget Request suggested shuttering over 30 USAID missions), Congress has been able to maintain level funding for ODA. Amid continued concerns over the level of resources available for foreign assistance, Trump's USAID Administrator, Ambassador Mark Green, has shown serious interest in DRM as a development objective important to his goal of placing USAID partners onto the "path to self-reliance." The Trump Administration's Fiscal Year 2019 budget request set aside \$75 million for DRM in a budget request that significantly cuts overall levels of development assistance, in a signal that DRM is receiving additional credence as a cost-effective and impactful development objective.

Whether this nascent emphasis on DRM translates to a long-term strategic shift in U.S. global development policy remains to be seen, but it merits further study as the responsibility for funding development continues to shift from donors to the governments of developing world while the efficiency of these governments to raise revenue to meet this responsibility remains a challenge.

<sup>40</sup> Postel, Eric. *The United States and the Future of Development Financing*. Modernizing Foreign Assistance Network panel discussion. July 14, 2016.

<sup>41</sup> USAID. "DRM Pilot Program Description." Washington, DC. United States Agency for International Development. [http://pdf.usaid.gov/pdf\\_docs/PBAAE382.pdf](http://pdf.usaid.gov/pdf_docs/PBAAE382.pdf) (Accessed July 26, 2016.)

## **Chapter 2 - Trade Facilitation in Sub-Saharan Africa**

In international trade, the negotiations over multilateral agreements such as the Trans-Pacific Partnership (TPP) and the North American Free Trade Agreement (NAFTA) tend to receive the greatest amount of attention as issues of market access, intellectual property and labor rights are debated and the world's largest economies are shaped through high-profile discussions.

While those negotiations garner the attention, a lesser known area of trade dealing with the “nuts and bolts” of global commerce known as trade facilitation has increasingly been prioritized by governments, the private sector and the World Trade Organization (WTO).

In December 2013, WTO members concluded negotiations on the Trade Facilitation Agreement (TFA) at the Bali Ministerial Conference as part of a wider “Bali Package.” This agreement set forth the principles by which WTO members agreed to promote global commerce and ease the flow of goods and services by making improvements to infrastructure, modernizing customs operations and harmonizing trade procedures. The Agreement struck in Bali was the culmination of years of discussions over an issue that had proven to be a major stumbling block toward progress on the Doha Development Round.

In the years following the Bali Package, OECD countries, multinational corporations and business groups like the International Chamber of Commerce engaged in a sustained effort to persuade the governments of the developing world to ratify the TFA, which required two-thirds acceptance of the WTO's 164 members. This effort was largely centered on the promise of greater investment in the developing world that would

result from the trade facilitation reforms called for in the Agreement. The WTO estimates that the TFA and its reforms could inject up to \$1 trillion into the global economy by reducing trade costs by 14.3 percent, and much of this investment would be focused in the developing world. This effort to persuade was successful, as on February 22, 2017, Chad, Jordan, Oman and Rwanda ratified the TFA, bringing it into force.

Implementation of the reforms called for in the TFA will require significant investment in areas such as infrastructure and government workforce. As a part of the effort to reach ratification, donor countries agreed to assist developing countries as they commit to TFA implementation, but with the understanding that ultimately the responsibility rests with the developing countries themselves.

The Bali Package represented a watershed moment for trade facilitation, but it was not the beginning. TFA implementation will build upon significant existing efforts of partner countries to address challenges that inhibit trade facilitation and as the developing world looks to follow through on their TFA commitments and increase spending on trade facilitation, an assessment of previous reforms targeting trade facilitation should guide the design of new reforms and the allocation of resources to implement them.

This chapter will examine the relationship between recent business reforms in Sub-Saharan Africa and the performance of trade logistics in the region to assess whether there is evidence that reforms have improved trade facilitation and, if so, which reforms have produced the improvements. Sub-Saharan Africa is the largest regional recipient of U.S. foreign assistance, with 32% of U.S. aid going to the continent, so focusing on the region would be relevant to policymakers.<sup>42</sup> Additionally, the governments of Sub-

<sup>42</sup> McBride, James. "How Does the U.S. Spend its Foreign Aid?" Council on Foreign Relations. October 1, 2018. <https://www.cfr.org/backgrounders/how-does-us-spend-its-foreign-aid>

Saharan Africa have instituted the most World Bank *Doing Business* reforms that are central to this chapter.

I anticipate finding that the overall emphasis on trade facilitation has accompanied more intensified activities by the governments of Sub-Saharan Africa by way of a greater number of reforms intended to promote trade facilitation. Furthermore, I anticipate that countries with more focus on reforms specifically targeting customs and trade will have the greatest impact on trade facilitation.

### **What Is Trade Facilitation?**

Research on trade facilitation has placed significant effort into defining the elements of the policy and the impact it has on international trade flows. This review assesses the current literature to provide a general definition of trade facilitation, the impact of trade facilitation efforts on trade flows in the developing world.

There is no standardized definition of trade facilitation, but in the most basic sense it can be defined as the “simplification of the trade interface” between trading partners.<sup>43</sup> According to the WTO, trade facilitation is about improving the regulatory interface between governmental bodies and traders at borders through “the simplification and harmonization of international trade procedures,” where trade procedures are the “activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade.”

There is general acceptance of a number of areas that can be improved through public and private interventions of trade facilitation and these areas can involve the

<sup>43</sup> Maur, Jean-Christophe. *Regionalism and Trade Facilitation: A Primer*. Washington, D.C.: The World Bank, 2008.

physical movement of goods or the exchange of information in service of that movement. Some of these elements include transportation infrastructure, regulatory coherence, customs procedures, financing, and corruption.

Wilson, Mann and Otsuki divide trade facilitation into two broad categories of “border” and “inside the border” issues and found that improvement in all of these areas has a positive effect on trade, but improvements at the border (in this case, port efficiency and customs administration) particularly impactful.<sup>44</sup> Maskus, Wilson and Otsuki focused on regulations and economic development and found that regulatory structures in the developing world have non-trivial costs and negative impact on investment and called on more comprehensive approaches to regulatory harmonization.<sup>45</sup>

There is discussion among economists over the link between trade and economic growth, but for the purposes of this paper we will presuppose a positive relationship between participation in the global economy through trade and economic growth. Several recent papers have confirmed this relationship between trade and economic growth in the African context, including Kummer-Noormamode,<sup>46</sup> Sakyi *et al.*,<sup>47</sup> and Brueckner and Lederman.<sup>48</sup>

Quantifying the impact of trade facilitation on trade flows is challenging, as modelling methodologies are imperfect and determining causality can be difficult.<sup>49</sup>

<sup>44</sup> Wilson, John S.; Mann, Catherine L.; Otsuki, Tsunehiro. 2004. Assessing the potential benefit of trade facilitation: A global perspective (English). Policy, Research working paper; no. WPS 3224. Washington, DC: World Bank.

<sup>45</sup> Mann, Catherine L, Tsunehiro Otsuki, and John S Wilson. Trade Facilitation and Economic Development : Measuring the Impact. Washington, D.C.: World Bank, 2003.

Maskus, Keith E, Tsunehiro Otsuki, and John S Wilson. The Cost Of Compliance With Product Standards For Firms In Developing Countries: An Econometric Study. Washington, D.C.: The World Bank, 2005.

<sup>46</sup> Kummer-Noormamode, S. Does Trade with China Have an Impact on African Countries' Growth? African Development Review, 26: 397-415, 2014.

<sup>47</sup> Sakyi, D. , Villaverde, J. , Maza, A. and Bonuedi, I. (2017), The Effects of Trade and Trade Facilitation on Economic Growth in Africa . African Development Review, 29: 350-361

<sup>48</sup> Brueckner, Markus; Lederman, Daniel. 2015. Effects of income inequality on aggregate output (English). Policy Research working paper; no. WPS 7317. Washington, D.C. : World Bank Group.

<sup>49</sup> Wilson, John; Catherine Mann and Tsunehiro Otsuki. “Assessing the Potential Benefit of Trade Facilitation: A Global Perspective.” World Bank Policy Research Working Paper no. 3224. The World Bank Group. Washington, DC. February 10, 2004.

Nevertheless, there is compelling evidence that efforts in trade facilitation have a positive effect on trade flows and export promotion. Clarke found that manufacturers are less likely to export to countries with a reputation for inefficient and outdated customs administration and a burdensome regulatory environment.<sup>50</sup> Iwanow and Kirkpatrick<sup>51</sup> found that a 10 percent improvement in trade facilitation would yield a 5 percent increase in the volume of exports and Clark, Dollar and Micco<sup>52</sup> found that improvements in transportation increases the volume of trade with the United States. Dollar, Hallward-Dreimeir and Mengistae found a negative relationship between increases in customs clearance times and exports in the developing world.<sup>53</sup> Wilson, Mann and Otsuki showed that infrastructure improvements and regulatory reforms can have greater impact on trade flows in different groupings of countries depending on region or level of economic development.<sup>54</sup>

According to Helble, research on the impact of trade facilitation on trade flows has focused on analyses of specific elements of trade facilitation for a grouping of countries and case studies on the trade facilitation environment in a single country.<sup>55</sup> Helble believes there are strengths to the data analyses in that they can provide detailed insight on the effect that narrow variables such as specific regulations or distance to ports

<sup>50</sup> Clarke, George R.G.. 2005. Beyond tariffs and quotas : why don't African manufacturers export more? (English). Policy, Research working paper ; no. WPS 3617. Washington, DC: World Bank.

<sup>51</sup> Iwanow, T. and Kirkpatrick, C. (2007), Trade facilitation, regulatory quality and export performance. *J. Int. Dev.*, 19: 735-753.

<sup>52</sup> Clark, Ximena, David Dollar and Alejandro Micco. "Port Efficiency, Maritime Transport Costs, And Bilateral Trade," *Journal of Development Economics*, 2004, v75(2,Dec), 417-450.

<sup>53</sup> Dollar, David, Mary Hallward-Dreimeier and Taye Mengistae. "Investment climate and international integration." *World Development*, Volume 34, Issue 9, 2006, p. 1498-1516

<sup>54</sup> Wilson, John; Catherine Mann and Tsunehiro Otsuki. Assessing the Benefits of Trade Facilitation: A Global Perspective." *The World Economy*. 2005, vol. 28, issue 6, 841-871

<sup>55</sup> Helble, Matthias; Mann, Catherine; Wilson, John S.. 2009. Aid for Trade Facilitation. Policy Research working paper; no. WPS 5064. World Bank.

can have on overall trade activity, however these narrow analyses have the weakness of being unable to determine whether these variables are the most significant actors on trade activity.

Duval surveyed trade facilitation experts on implementation costs associated with 12 different trade facilitation measures and found that long-term savings and benefits of these measures far outweighed the cost of implementation, and that the most significant cost to implementation of trade facilitation measures may be political, rather than monetary, since it would require significantly changing the way things are done within government agencies.<sup>56</sup>

In an analysis of 20 sub-Saharan African countries over the period 2007-2014, Seethanah, Sannassee and Fauzel found a positive and significant correlation between trade facilitation and trade flows and that a 1 percent increase in trade facilitation accounted for a .77 percent increase in trade volume.<sup>57</sup> The analysis also found evidence of a bi-causal relationship between trade facilitation and trade flows as well as evidence of a relationship between trade facilitation and economic growth in the region. Seethanah, Sannassee and Fauzel conclude by arguing for a commitment from African governments to work to reduce trade costs and non-tariff barriers. This recommendation is complementary to the WTO that found that strong political will and a commitment to trade facilitation at the highest level of government is the single most important factor in successful trade facilitation reform in the developing world.<sup>58</sup>

<sup>56</sup> Duval, Yann. "Cost and Benefits of Implementing Trade Facilitation Measures under Negotiations at the WTO: an Exploratory Survey," Working Papers 306, Asia-Pacific Research and Training Network on Trade (ARTNeT). UNESCAP and IDRC, Canada

<sup>57</sup> Seethanah, Boopen, Rajah Vinesh Sannassee, and Sheereen Fauzel. "Trade Facilitation and Trade Flows: Evidence from Africa." World Trade Organization: Trade Costs and Inclusive Growth. 2016. [https://www.wto.org/english/res\\_e/booksp\\_e/trade-costs-incl-growth\\_chap7\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/trade-costs-incl-growth_chap7_e.pdf)

<sup>58</sup> World Trade Organization. "The Challenges of Implementing the Trade Facilitation Agreement." World Trade Report 2015. Accessed August 22, 2018. [https://www.wto.org/english/res\\_e/booksp\\_e/wtr15-2e\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/wtr15-2e_e.pdf)



## Impact of Reforms on Trade Facilitation

The purpose of this chapter is to assess whether recent efforts to improve trade facilitation in Sub-Saharan Africa have had the desired effect of promoting trade and commerce. To test for such a relationship, I used data from the World Bank Group's *Doing Business* series and its separate *Logistics Performance Index (LPI)* to see if there is correlation between trade facilitation policies instituted by the governments in Sub-Saharan Africa have put into instituting reforms and an improving environment as experienced by the private sector on the ground.

Before a discussion of the methodology used for this analysis, I would like to provide a brief description of the indicators and what they can tell us about Sub-Saharan Africa. The World Bank's *Doing Business* project was launched in 2002 and provides objective measures of government policies and their impact on small and medium-size enterprises operating within that government's borders. *Doing Business* examines the regulatory environment and tracks changes in policy that can affect businesses positively and negatively in over 190 economies with a focus on ten different indicator areas: Starting a Business, Dealing with Construction Permits, Getting Electricity, Registering Property, Getting Credit, Protecting Minority Investors, Paying Taxes. Enforcing Contracts, Resolving Insolvency and Trading Across Borders. In addition to the data provided at the country level, *Doing Business* also publishes more detailed national and sub-national reports.<sup>59</sup>

<sup>59</sup> In January 2018, *Doing Business* became the subject of controversy when the World Bank's Chief Economist Paul Romer apologized to Chile for what he said were politically motivated changes to methodology in the ease of doing business index rankings that are published in the *Doing Business* report. Romer alleged that the methodology for the index may have been manipulated in order to politically damage the leadership of the Government of Chile. Romer subsequently softened his criticism, but nevertheless the World Bank announced an external review of the indicators for Chile shortly thereafter. This paper does not utilize the rankings that were the source of controversy, but instead focuses on reforms identified by the *Doing Business* report. For further reading please see Zumbun, Josh. "Revamps of World Bank's Rankings Amplified Chile's Slide." *Wall Street Journal*. January 18, 2018.

*Doing Business* has recorded over 3,188 regulatory reforms worldwide since *Doing Business 2006*, and this chapter focuses on the reforms in Sub-Saharan Africa that were instituted during the period of 2007-2017. While Europe and Central Asia has had the highest percentage of countries instituting positive reforms during this period, Sub-Saharan Africa recorded the highest total of reforms in 2016/2017 with 83 reforms across all areas, the culmination of a decade-long trend of increasing reforms in the region. In addition to these positive reforms, *Doing Business* also tracks changes to policy that inhibit business. These negative policy changes are accounted for in this analysis by testing the net number of reforms, with a negative policy change negating a positive reform in the total.

During the period of 2007-2017, *Doing Business* recorded a total of 732 regulatory reforms in Sub-Saharan Africa that made it easier to do business. The category that experienced the greatest number of reforms was the Starting a Business category with 147. The category with the fewest reforms was Getting Electricity with 20. The country in Sub-Saharan Africa responsible for implementing the most reforms over the period is Rwanda with 46 reforms, while Somalia and South Sudan, a country established in 2011, did not institute any reforms during the period and Eritrea was responsible for only one reform.

<https://www.wsj.com/articles/revamps-of-world-banks-rankings-amplified-chiles-slide-1516304479> and “World Bank Statement on the *Doing Business* Index.” World Bank. January 13, 2018. <https://www.worldbank.org/en/news/statement/2018/01/13/world-bank-group-statement-on-doing-business-index>

**Table 2.1: ‘Doing Business’ Reforms in Sub-Saharan Africa (2007-2017)**

	Starting a Business	Construction Permits	Trading Across Borders	Getting Electricity	Registering Property
Reforms	147	69	101	20	86
Negative Policies	19	24	14	3	19
	Getting Credit	Protecting Minority Investors	Paying Taxes	Enforcing Contracts	Resolving Insolvency
Reforms	103	38	78	43	42
Negative Policies	3	1	32	1	1

Source: World Bank. Doing business 2018. Washington, D.C. : World Bank Group

As a measure of the impact of efforts on trade facilitation, I used data from the Logistics Performance Index (LPI) developed by the World Bank to help countries to identify challenges to trade logistics performance. The LPI is made up of both qualitative and quantitative data and is based on a worldwide survey of global freight forwarders and express carriers and performance data from key components of supply chains in country. The LPI and its constituent categories provide a better understanding of how efficiently logistics and supply chains operate in certain countries by providing a measure based on the perceptions of logistics professionals who operate in country on a regular basis.

LPI focuses on six key categories: clearance process efficiency; infrastructure; ease of shipments; competence and quality of logistics services (e.g., transport operators, customs brokers); ability to track and trace consignments; and timeliness of shipments. All of these categories are important elements of trade facilitation and serve as a helpful measure of the private sector’s assessment of trade facilitation efforts in each country for which the data is available.

The World Bank has been scoring countries on these categories since the first *Connecting to Compete* was released in 2007, a report born from a shared recognition

among World Bank countries of the importance of logistics performance and trade facilitation to promoting economic growth and integration.<sup>60</sup> Subsequent LPI updates were published in 2010, 2012, 2014, 2016 and 2018. The LPI provides each of the previously mentioned categories a global rank and a score of 0-5 based on the results of the worldwide survey. Unsurprisingly, the developed economies of the OECD rank at the top in each of the editions of the LPI. However, the LPI also provides helpful information on where countries rank among their income group and regional peers and whether logistical performance in a given country or sector is trending in a certain direction. For instance, in the 2018 executive summary of the LPI, India, Indonesia, Vietnam and Cote d'Ivoire were all referenced as top performers in the lower middle-income group.

As a region, Sub-Saharan Africa is the lowest ranked region in the 2018 LPI in overall score and in most categories, with the lone exception of Shipments where South Asia's 2.48 score comes in lower than Sub-Saharan Africa's 2.52 score. Regionally, Europe and Central Asia lead the world with an overall LPI score of 3.24, followed by East Asia and Pacific (3.15), Middle East and North Africa (2.78), Latin America and Caribbean (2.66), South Asia (2.51) and Sub-Saharan Africa (2.45.)

During the period between 2007 report and the 2018 report, Sub-Saharan Africa improved in all categories of LPI with the exception Timeliness which received a score of 2.77 in both years, despite enjoying an increase in that same category in the reports of the interim years. The overall score for Sub-Saharan Africa increased from 2.35 in 2007 to 2.45 in 2018. The categories with the largest increase during that period were Tracking

<sup>60</sup> World Bank. "About the Logistics Performance Index." The World Bank Group. Accessed August 31, 2018. <https://lpi.worldbank.org/about>

and Tracing, which increased .19 from 2.31 in 2007 to 2.50 in 2018, and Shipments which increased .16 from 2.36 in 2007 to 2.52 in 2018.

For each country in Sub-Saharan Africa during the period of 2007-2017, I tested for relationships between the pro-business reforms instituted over that period as measured by *Doing Business* and the difference in LPI scores from 2007 and 2018. The LPI scores from 2007 are a good measure of the environment on the ground before any of the tracked reforms took place, as the scores are derived from a survey that was completed in November 2007. Likewise, the 2018 LPI is useful as a measure of industry perceptions on logistics performance after *Doing Business* reforms were instituted, as the survey was conducted from September 2017 to February 2018.

As noted by Marti, Martin, and Puertas, *Doing Business* and LPI are often compared to one another, but they are distinct in several ways and measure different aspects of the business environment in country.<sup>61</sup> *Doing Business* is an assessment of a country's policies, while LPI based on the private sector's assessment of their experiences in country. These issues interplay with each other but are not endogenous.

For the analyses, I computed bivariate correlations to examine relationships between overall reforms and overall LPI scores; overall reforms and constituent LPI category scores; category reforms and overall LPI scores; category reforms and category scores. I also examined relationships between negative policies as tracked by *Doing Business* and LPI scores.

I initially had the intention of using regression analyses to examine the relationship between trade facilitation reforms and the impact on LPI. However, I

<sup>61</sup> Marti, Luisa; Juan Carlos Martin and Rosa Puertas. "A DEA-Logistics Performance Index." *Journal of Applied Economics*. Vol 20, No. 1 (May 2017), 169-92.

ultimately decided that my intention was to examine whether a relationship between the reforms and the logistics performance exists rather than test for the impacts that one may have on the other, so correlations were the more appropriate analysis.

As mentioned in the introduction, I anticipate that the countries responsible for the most reforms will also have the greatest improvement in logistics performance, thus I expect a positive relationship between Doing Business reforms and LPI score improvements. Furthermore, among the categories of reforms, I expect the highest correlation between the “Trading Across Borders” category and LPI improvement.

## Results

The results show a statistically significant relationship between overall *Doing Business* reforms during the period of 2007-2018 and increases in overall LPI score, supporting the hypothesis that intensified focus on promoting a more business friendly environment through reforms is related to improved logistics performance. In other words, the more time and resources governments committed to reforms across all *Doing Business* categories, the more likely it was that all elements of trade facilitation as measured by LPI improved.

**Table 2.2. Overall Doing Business Reforms and Overall LPI**

Doing Business Category		Logistics Performance Index (Overall Score) difference from 2007 to 2018
Doing Business # Positive Reforms (Sum of all other categories)	Pearson Correlation	.591**
	Sig. (2-tailed)	.000
	N	35
Doing Business # Negative Reforms (Backtracks)	Pearson Correlation	.185
	Sig. (2-tailed)	.288
	N	35

While this suggests that government commitment to reforms improves trade facilitation, there was no evidence to suggest that negligence through negative policy changes has any relationship with changes to LPI, either negatively or positively.

The analyses also showed that there are statistically significant relationships between overall reforms and all constituent categories of the LPI. The highest correlation is between overall reforms and the overall LPI score ( $r = .591, p < .001$ ), while the LPI category with the strongest relationship with overall reforms is Infrastructure ( $r = .567, p < .001$ ). The correlations between overall reforms and the remaining LPI categories are as follows: Logistics ( $r = .503, p < .01$ ), Shipments ( $r = .448, p < .01$ ), Customs ( $r = .426, p < .05$ ), Tracking ( $r = .397, p < .05$ ), and Timeliness ( $r = .340, p < .05$ ).

The strength of the relationship between reforms and LPI varies depending on the category of reform. The category of reform with the highest correlation with overall LPI is Getting Credit ( $r = .623, p < .001$ ), followed closely by Dealing with Construction Permits ( $r = .619, p < .001$ ). Dealing with Construction Permits is also the only *Doing Business* category of reform showing a statistically significant relationship with overall LPI and all LPI categories. The correlation between Construction reforms and the LPI category of Timeliness gives Construction the distinction of being the only category of reforms showing significant relationships across all facets of LPI. Resolving Insolvency, Enforcing Contracts, and Getting Credit all exhibited significant correlations across all LPI categories, with the exception of Timeliness.

My hypothesis that reforms more focused on trade facilitation would have the greatest positive association with LPI is not supported by the strength of Dealing with Construction Permits or by the other categories showing relationships across all but one

of the LPI categories: Getting Credit, Resolving Insolvency and Enforcing Contracts. The relationship that these categories have on logistical performance is worth further study and I would be particularly interested to see whether these categories, which seem closely associated with the regulatory environment, are a strong leading indication for an improving overall business environment that in turn helps foster improved trade facilitation.

***Table 2.3: Trade Across Borders and Overall LPI, Customs, Infrastructure***

Doing Business Category		Overall LPI	Customs	Infrastructure
Trade Across Borders # Positive Reforms	Pearson Correlation	.366*	.406*	.388*
	Sig. (2-tailed)	.030	.015	.021
	N	35	35	35

The strength of the relationship between the Trade Across Borders category of reforms to overall LPI, Customs and Infrastructure, helps support my hypothesis that reforms focused on trade facilitation would have a positive impact on LPI. Trade Across Borders had the highest significance among all categories with Customs ( $r = .406, p < .05$ ), which is an area of trade facilitation that is highly specific to trade. Whereas improvements to sectors such as infrastructure are important to trade facilitation, they can often be accomplished through programs that are not specifically designed with trade facilitation in mind or contemplate it as a secondary goal. For customs regimes to be modernized and improved, it requires a targeted approach and the data support this.

Paying Taxes and Getting Electricity were the only reform categories without any significant relationships with LPI. I found this somewhat surprising, given that both of these issues are cross-cutting and are regularly identified by development economists and the private sector as critical factors contributing to investment and growth. While neither category may have a direct impact on trade facilitation, I expected to see a relationship



that could be attributed to the positive secondary effects of reforms focused on electricity and tax administration.

## **Chapter 2 Conclusion**

The introduction of the World Bank's Logistics Performance Index in 2007 came from the shared acknowledgement of the development community and the private sector that issues of trade facilitation are a critically important and regularly misunderstood aspect of global development.

This chapter identified a general relationship between pro-business reforms undertaken by the governments of Sub-Saharan Africa and an improvement in the logistical performance in those countries as measured by private sector experts on the matter. It was inconclusive as to whether the reforms specifically targeting trade facilitation had the greatest impact on trade facilitation but suggested a more general relationship between a government committed to improving the business and regulatory environment and improved logistical performance in that country.

More research into the types of reforms that have the greatest impact on trade facilitation is warranted in order to better understand where development resources should be targeted to improve the flow of goods both internally and across borders in the developing world.

As the private sector and partner country interest in trade facilitation continues to grow, it will be interesting to see whether development experts, NGOs and development agencies begin to place greater emphasis on programs and resources that target the “nuts and bolts” of global commerce.

### **Chapter 3 - MCC and the Constraints That Bind Us**

In a March 14, 2002, speech at the Inter-American Development Bank in Washington, DC, President George W. Bush called for a new type of development assistance that placed accountability and effectiveness at the center of efforts to alleviate global poverty and refocused attention on projects that promote economic growth in the developing world.<sup>62</sup> This speech offered the earliest vision of what would ultimately become the Millennium Challenge Corporation (MCC), an independent development agency of the U.S. federal government that opened its doors in 2004 embracing an evidence-based approach to economic growth-driven development built upon a rigorous selection process that placed partner country commitment to its citizens at the forefront of its work.

From the start, the MCC was notable for several characteristics that set it apart from other development agencies including an insistence on accountability through stringent eligibility criteria in areas such as political and economic freedom, the involvement of the partner country in the design of the programming from the outset, and—the focus of this chapter—the agency’s primary focus on promoting economic growth by addressing the constraints to private investment.

The architects of the MCC recognized economic growth as a critical driver of global poverty alleviation and the growing evidence that private sector investment was key to promoting that growth. Leveraging the private sector and prioritizing market-based approaches was certainly not a new concept and had been discussed by development

<sup>62</sup> Bush, George W. “Remarks at the Inter-American Development Bank.” Public Papers of the President of the United States George W. Bush. Government Printing Office. Pages 408-412. March 14, 2002.

policy experts for decades. Deepak Lal helped initiate a real debate in development policy circles when he published “The Poverty of Development Economics” in 1983, in which Lal criticized the longtime resistance of the development community to embrace market principles and argued for a shift in development policy focus from state-based to market-driven approaches.<sup>63</sup> Although Lal his call for minimal state involvement in development was ultimately not heeded, several of his critiques of the status quo gained favor in important multilateral fora such as the World Bank but had never been a foundational principle of a new development agency until the MCC.<sup>64</sup>

The MCC’s development assistance is provided through five-year “Compacts” that are awarded by the MCC Board of Directors only after a partner country qualifies by scoring positively on a set of several objective performance indicators organized in three categories: Ruling Justly, Investing in People and Economic Freedom. Each MCC partner country takes the lead from the beginning in designing and implementing the Compact in a process that is both transparent and aimed at directly addressing the binding constraints to economic growth in the country. This was a new approach that departed from the grant-based development assistance programs of the past that were criticized for being poorly designed with unclear objectives and limited results. MCC’s goal from its inception was to test a new model of development that placed country-ownership, accountability and an exclusive focus on economic growth and to see if this new model could achieve results that other development agencies, such as USAID, were not.

<sup>63</sup> Lal, Deepak. “The Poverty of Development Economics: Second Edition.” MIT Press. 2000 (originally published 1983.) Cambridge.

<sup>64</sup> World Bank. “Development in Practice: Private Sector Development in Low-Income Countries.” The World Bank Group. Washington, DC. 1996.

Since its founding in 2004, MCC has awarded 33 compacts in 27 countries worth almost \$12 billion.<sup>65</sup> In addition to the Compacts, MCC has also established smaller Threshold Programs in 27 countries. These Threshold Programs have total approximately \$600 million and are intended to help a partner country improve its performance in the areas measured by MCC indicators in order to ultimately become eligible for a full Compact but are governed by the same principles that have guided Compact development and execution.<sup>66</sup>

While the MCC is notable for several characteristics that separate it from other development agencies such as eligibility requirements and the five-year duration of the Compact, for the purposes of this chapter we will be focused on the MCC constraints-to-growth analysis (CA), an element of Compact development that embodies the agency's stated commitment to country ownership, a rigorous data-based approach and focus on addressing obstacles to economic growth. The CAs are led by the partner country in cooperation with the MCC to identify the binding constraints to private sector investment that are inhibiting economic growth in the country. The MCC Compact is then designed for the purpose of addressing the constraints identified through programming supported by MCC's investment.

This chapter will assess MCC's utilization of CAs to date by comparing the results of the CAs (ie. the binding constraints to growth identified through the analysis) with the resulting MCC Compacts. The first question considered is whether the Compacts strictly adhere to addressing the constraints identified in the CAs or if any Compacts have

<sup>65</sup> Congressional Research Service (CRS). "Millennium Challenge Corporation." Library of Congress. Washington. RL32427. Updated April 18, 2018.

<sup>66</sup> Ibid.

been designed in an attempt to address development challenges other than issues inhibiting private sector-led economic growth. The second question will be whether the lead U.S. development agency, the United States Agency for International Development (USAID) has incorporated any of the learnings from the CAs into their own programming.

The relationship between poverty alleviation and economic growth has been well-established and the evidence supporting this relationship has been noted in the previous chapters of this thesis. This chapter considers whether the Millennium Challenge Corporation, an agency that has placed addressing challenges to economic growth at the center of its mission, has adhered to that mission and whether this refocus on economic growth has influenced the programming at USAID.

### **Background: MCC Constraints-to-Growth Analyses**

In that same speech in 2002, President Bush noted that countries in the developing world that adopt “sound laws and policies will attract more foreign investment. They will earn more trade revenues. And they will find that all these sources of capital will be invested more effectively and productively to create more jobs for their people.”<sup>67</sup> With this, the Bush Administration was signaling its intention to reorient U.S. foreign assistance programs toward addressing policies and circumstances in country that discouraged the investment of private sector resources that drive growth.

For this change in emphasis to be reflected in MCC’s programming, it was critical that the private sector-led economic growth focus be incorporated into the design of each

<sup>67</sup> The White House. “President Proposes \$5 Billion Plan to Help Developing Nations. Washington. March 14, 2002 (accessed June 12, 2019.) <https://georgewbush-whitehouse.archives.gov/news/releases/2002/03/20020314-7.html>

compact. To that end, countries selected by the MCC Board of Directors for a compact must assemble a compact Development Team led by a coordinator and made up of local economists, subject-matter experts and technical specialists. The Compact Development Team, assisted by MCC staff in country, is then tasked with beginning the two- to three-year process of developing a compact. The central work of the first phase of this process, called the Preliminary Analysis phase, is the Constraints Analysis.<sup>68</sup>

The MCC bases the guidelines for the Constraints Analysis on the work of economists Ricardo Hausman, Dani Rodrik and Andres Velasco (HRV) and their 2005 paper, “Growth Diagnostics,” in which the authors developed an analytical framework to identify issues inhibiting economic growth and prioritize addressing them. The HRV framework requires the Compact Development Teams to consider the historical context of economic growth in the country and to consider a series of questions and issues that a potential investor would consider before investing that are broadly included in three categories: expected return on investment, risk and costs. A series of diagnostic questions developed by HRV guide the Compact Development Teams in their Constraints Analysis and the results are intended to identify binding constraints to growth in a way that is independent of outside influence.

When developing their growth diagnostic framework, HRV were motivated by a desire to avoid a one-size-fits-all approach to development policies and to be sensitive to the fact that the impact of reforms is heavily dependent upon the environment in which they are implemented. The HRV framework was developed under the assumption that

<sup>68</sup> MCC. “Constraints Analysis.” Millennium Challenge Corporation. Washington. (Accessed June 2019.) <https://www.mcc.gov/our-impact/constraints-analysis>

economic growth is the central challenge facing the countries of the developing world and that applying an identical growth strategy for all countries will ultimately not deliver results. HRV further held that prioritization of issues is a critical concern for countries in the developing world that may not have the resources to properly address the full list of issues facing them simultaneously. The diagnostic questions that drive the HRV approach are conceptualized in the form of a decision tree and the authors believe that at the end of the process policymakers will have a clear diagnosis of the issues prohibiting growth that is independent of biases associated with political pressures and/or prevailing development theories.

All of the CAs completed to date have been guided by analytical framework laid out in HRV's 2005 paper and updated by the authors in subsequent works published by the World Bank. A few of the CAs have also incorporated additional analysis into the CA, such as Nepal's CA which included information from a previous analysis completed jointly by the Asian Development Bank, the United Kingdom's Department For International Development (DFID) and the UN's International Labor Organisation (ILO), but HRV remains the foundation. Each CA identifies a few binding constraints, typically two to three of them.

As illustrated by Table 3.1, there are several development challenges that appear repeatedly in these CAs, with governance, transportation and infrastructure issues the leading constraints to private sector investment, which tracks closely with the issues tracked by the World Bank *Doing Business* series featured in the previous chapters.

**Table 3.1: Binding Constraints by Sector (As Identified by CAs)**

Finance/Access to Credit	Transport	Energy	Water and Sanitation	Corruption	Governance	Land/Property Rights
2	16	14	5	3	21	7
Crime	Health	Irrigation/Water	Geography	Innovation	Education	Other
2	5	3	3	2	10	8

Source: MCC, Constraints Analysis: <https://www.mcc.gov/our-impact/constraints-analysis>

## MCC Programs and Addressing Binding Constraints

For this analysis, the Binding Constraints identified by CAs in MCC partner countries were compared to the projects that the resulting Compacts funded. For example, the CA conducted in Niger and completed in identified three binding constraints to growth: access to water for agriculture and livestock; government regulation of business; and regulatory and institutional barriers to trade.<sup>69</sup> The resulting \$437 million MCC Compact in Niger funded two major projects: *Climate-Resilient Communities*, aimed at increasing incomes for small-scale agriculture- and livestock-dependent families, and *Irrigation and Market Access*, intended to modernize irrigated agriculture and flood management systems with sufficient trade and market access.<sup>70</sup> Although the Niger Compact entered into force in January 2018 and the initial assessments of its effectiveness have yet to be reported, for the purposes of this analysis we can confirm that the Niger Compact was designed to address one of the binding constraints identified by the CA, access to water for agriculture and livestock.

<sup>69</sup> MCC. "Niger Constraints Analysis." Millennium Challenge Corporation. Washington. January 2014 (accessed June 2019.) [https://assets.mcc.gov/content/uploads/2017/05/Niger\\_CA\\_withCover.pdf](https://assets.mcc.gov/content/uploads/2017/05/Niger_CA_withCover.pdf)

<sup>70</sup> MCC. "Niger Compact. Millennium Challenge Corporation." Accessed June 2019. <https://www.mcc.gov/where-we-work/program/niger-compact>



Another binding constraint, regulatory and institutional barriers to trade, is intended to be at least partially addressed through the *Irrigation and Market Access* project, by providing technical assistance to farmers as they work to establish market platforms and participate in the value chain. However, that is an ancillary benefit of the project which is specifically designed to take on the challenges with irrigation in Niger.

The Niger Compact therefore addresses two binding constraints identified by the CA, one directly and the other tangentially, while the binding constraint of government regulation of business is not addressed by either project funded by the compact. In addition, one of the two projects funded by the compact, *Climate-Resilient Communities*, is focused on addressing environmental issues facing farmers in Niger, which was not a constraint identified in CA.

Table 3.2 shows the binding constraints identified in the CAs for the Niger Compact and 28 other MCC programs (Compacts and Threshold Programs) and the resulting projects funded.

**Table 3.2: Binding Constraints from CAs and Resulting Compact Projects**

Compact	Binding Constraints	Compact Projects	Compact	Binding Constraints	Compact Projects
Benin II	Transport, Energy, Corruption, Governance, Education	Energy, Governance	Mongolia II	WASH, Governance, Health, Weak Macroeconomic Environment	WASH
Cabo Verde II	Transport, Energy, WASH, Geography, Innovation	WASH, Land	Morocco II	Governance, Land, Education	Land, Education
Cote d'Ivoire	Transport, Governance, Land, Education	Transport, Education	Mozambique	Transport, WASH, Governance, Health, Geography, Education	Agriculture, Land, Transport, WASH
El Salvador II	Crime, Low Productivity in the Tradable Sector	Education, Finance (Tradable Sector)	Nepal	Transport, Energy, Governance, Labor	Transport, Energy
Georgia II	Transport, Education	Education	Niger	Governance, Irrigation, Regulatory and Institutional Barriers to Trade	Irrigation, Environment
Ghana II	Finance, Energy, Land	Energy	Philippines	Governance, Reduced Fiscal Space	Transport, Reduced Fiscal Space
Guatemala	Governance, Health, Education	Governance, Education	Senegal	Transport, Energy, Governance, Irrigation	Transport, Irrigation
Honduras	Corruption, Governance, Crime	Transport, Finance, Education	Senegal II	Energy, Governance	Energy
Indonesia	Transport, Energy, Corruption, Governance, Education	Environment, Health, Governance	Sierra Leone	Transport, Energy, WASH	Energy, WASH, Governance
Jordan	Governance, Geography	WASH	Sri Lanka	Transport, Governance, Land	Transport, Land
Kosovo	Energy, Governance, Environmental Services	Energy, Governance	Tanzania II	Transport, Energy, Land	Transport, Energy
Lesotho II	Governance, Land, Health, Education	Health, Finance, WASH	Togo	Land, ICT services	Lands, ICT Services
Liberia	Transport, Energy	Transport, Energy	Tunisia	Governance, Labor	Governance, WASH
Malawi	Finance, Transport, Energy, Irrigation, Education	Energy	Zambia	Transport, Energy, WASH, Health, Innovation, Education	WASH
Moldova	Transport, Governance	Transport, Irrigation			

Source: MCC, Constraints Analysis: <https://www.mcc.gov/our-impact/constraints-analysis>

An analysis of the binding constraints identified by CAs and the resulting compact projects finds that 16 compacts exclusively funded projects that addressed binding constraints identified in the CA (*Benin II, Cote D'Ivoire, Georgia II, Ghana II, Guatemala, Kosovo, Liberia, Mongolia II, Morocco II, Nepal, Senegal, Senegal II, Sri Lanka, Tanzania II, Togo and Zambia*); 11 compacts funded at least one project that directly addressed a binding constraint, but also funded projects outside of the scope of the constraints identified in the CA (*Cabo Verde, El Salvador II, Indonesia, Lesotho II, Malawi, Moldova, Mozambique, Niger, Philippines, Sierra Leone and Tunisia*); and two

of the compacts did not address any of the binding constraints identified in the CA (*Honduras and Jordan*.)

Congressional Notifications—the official notices MCC is required to send to authorizing and appropriating committees of Congress before moving forward on a compact or threshold program—are helpful in providing additional insight into the rationale behind each project funded by MCC.

For Jordan, the Congressional Notification dated September 1, 2010, states that the compact’s projects “align closely with Jordan’s analysis of constraints to growth,” however, there is no additional information as to how it aligns with the CA or how it will address the binding constraints the CA identified and subsequent Congressional Notifications also do not provide additional information.<sup>71</sup> The CA for Jordan found that the water infrastructure in the country was adequate and that there “was little evidence that water scarcity has been a constraint to growth.” However, the CA did anticipate that access to water would deteriorate and identified it as an emerging and critical issue that will need to be addressed. Therefore, the Jordan Compact can be said to be addressing a critical issue that could evolve into a binding constraint, but not a current binding constraint such as the high costs of starting a business. In the case of Honduras, none of the Congressional Notifications addressed the CA or explained why the compact’s projects would not be addressing the binding constraints that were identified by the CA:

<sup>71</sup> MCC. “Jordan, Compact Signing CN.” Millennium Challenge Corporation Congressional Notification. Washington. October 28, 2010 (accessed June 2019.) <https://assets.mcc.gov/content/uploads/2017/05/cn-10282011-jordan.pdf>.pdf  
MCC. “Jordan, Intent to Negotiate.” Millennium Challenge Corporation Congressional Notification. Washington. July 8, 2010 (accessed June 2019.) <https://assets.mcc.gov/content/uploads/2017/05/cn-072210-jordan-intenttonegotiate.pdf>

corruption, governance and crime. The compact itself was terminated before completion, due to the removal of the democratically elected government from office.<sup>72</sup>

Jordan and Honduras represent the significant cases in which the CAs appear to have been either disregarded or downplayed during the design phase of the compacts. The reasons for this are not clear, but both involved CAs that were conducted relatively early in MCCs existence and the compacts might have been designed in a context in which CAs were not yet fully embraced by field staff and partner governments and is an area worth additional inquiry.

To gain a better understanding of how embedded CAs are into the development of a compact and how other prerogatives can influence the process, it is helpful to consider the details of specific compacts. In the next two sections, we will consider the MCC Compact in Indonesia, one of MCC's more ambitious compacts in terms of funding and one of the compacts identified as addressing both binding constraints identified by the CA and other issues not captured in the CA as inhibiting economic growth, and the MCC Compact in the Philippines, another highly resourced compact from the same region.

### **Indonesia Compact**

On November 19, 2011, Secretary of State Hillary Clinton and Indonesia's Finance Minister Agus Martowardojo signed a \$600 million MCC Compact for Indonesia to focus on mitigating climate change, addressing malnutrition in children and reforming government procurement practices. In her remarks at the signing ceremony, Secretary

<sup>72</sup> MCC. "Honduras, Compact Signing CN." Millennium Challenge Corporation Congressional Notification. June 18, 2005 (Accessed June 2019). <https://assets.mcc.gov/content/uploads/2017/05/cn-061705-honduras.pdf>  
MCC. "Honduras, Pre-Compact Signing CN." Millennium Challenge Corporation Congressional Notification. May 21, 2005 (Accessed June 2019). <https://assets.mcc.gov/content/uploads/2017/05/cn-052005-honduras.pdf>  
MCC. "Honduras, Intent to Negotiate." Millennium Challenge Corporation Congressional Notification. October 13, 2004 (Accessed June 2019). <https://assets.mcc.gov/content/uploads/2017/05/cn-101204-honduras.pdf>

Clinton noted that MCC and the Government of Indonesia “had worked for almost three years” on the development of the Compact and that it was particularly notable for its size and for addressing sectors previously not addressed by MCC, namely climate mitigation and childhood nutrition.<sup>73</sup> The resourcing provided to the Green Prosperity Project—the climate mitigation program funded by MCC—represented over half of the funds provided by the Compact (\$312 million), making it one of the largest single projects funded by the MCC overall.

***MCC Indonesia Compact – Projects***

**Community-Based Health and Nutrition to Reduce Stunting Project - \$134,200,000**

**Green Prosperity Project - \$312,700,000**

**Procurement Modernization Project - \$67,300,000**

The CA that informed the design of the Indonesia Compact also seems to be an outlier. Rather than the country-led analysis undertaken in partnership with MCC which is typical of other Compacts, the Indonesia Compact uses a third-party 2010 Asian Development Bank (ADB) analysis completed with the support of the ILO and the Islamic Development Bank (IDB).<sup>74</sup> This suggests a less methodical joint-examination, led by the Indonesian team formed for the compact, of the underlying constraints to economic growth in Indonesia.

The ADB analysis, which was completed in 2010 and guided by the same HRV growth diagnostic framework that informs MCC CAs, found that the binding constraints to inclusive economic growth in Indonesia were (1) inadequate infrastructure, (2)

<sup>73</sup> Clinton, Hillary Rodham. “Remarks at Millennium Challenge Corporation Signing Ceremony.” State Department. November 19, 2011 (accessed June 2019) <https://2009-2017.state.gov/secretary/20092013clinton/rm/2011/11/177396.htm>

<sup>74</sup> ADB, et al. “Indonesia: Critical Development Constraints.” Asian Development Bank (ADB), International Labour Organization (ILO), and Islamic Development Bank (IDB). 2010 (accessed June 2019) [https://www.mcc.gov/content/uploads/2017/05/Indonesia\\_CA\\_withCover.pdf](https://www.mcc.gov/content/uploads/2017/05/Indonesia_CA_withCover.pdf)

weaknesses in governance and institutions and (3) unequal access to primary and secondary education. The ADB analysis concluded that investments focused in these three areas would be necessary to reduce poverty and restore and enhance Indonesia's global competitiveness.

Although the ADB analysis accompanies the Indonesia Compact and serves as the CA intended to inform the design of the compact, a comparison between the binding constraints identified by the ADB analysis and the projects funded by the compact show a disconnect between the design of the compact and the analysis. There is one reference to nutrition in analysis, in which the authors note improvements in nutritional outcomes in Indonesia as a positive trend in the health sector, but adverse nutritional outcomes such as stunting are not referenced in the analysis as a binding constraint to growth. Studies show that there is a loss of productivity in the workforce due to adults who were undernourished as children and that it can have significant effects on the economy.<sup>75</sup> However, these economic implications are not evident until years after early childhood, which is an underlying reason for why nutrition is said to be an area of global health that has been historically underinvested. Stunting, in other words, is not identified by the HRV growth diagnostic because while it is a persistent problem that impacts the productivity of the workforce, it cannot be isolated in the growth diagnostic tree as a singular issue that is inhibiting private investment in Indonesia. Additionally, the long-term nature of poor nutrition as a global health issue suggests that it would be impossible to measure the economic rate of return of an investment within the five-year window of

<sup>75</sup> Spooner, Samantha. "Why stunting remains a major challenge." World Economic Forum. October 29, 2015. <https://www.weforum.org/agenda/2015/10/why-stunting-remains-a-major-challenge/>

an MCC compact or shortly thereafter—a key aspect of MCC’s data-driven and results-oriented approach.

Similarly, the underlying impetus for investment in the Green Prosperity Project is not evident in the ADB analysis. The authors identify Indonesia as a serious emitter of harmful greenhouse gases and suggest that cleaner sources of energy and a reduction of deforestation rates are important aims that will benefit Indonesia’s development in the long-term. However, neither access to energy nor the nature of the energy sector itself were identified as binding constraints in the ADB analysis. Developing green energy may be a laudable goal, but it is not a binding constraint to growth in Indonesia. In addition to the lack of a clear connection to promoting economic growth, the Center for Global Development (CGD) found that the Green Prosperity Project was approved despite limited details available on the cost-effectiveness of the activities to be undertaken as a part of the project.<sup>76</sup>

The smallest piece of the MCC compact in Indonesia, a procurement modernization project intended to encourage efficiency and discourage corruption in public procurement processes, is addressing an area specifically identified by the ADB as a binding constrain to economic growth in Indonesia.

In 2016, MCC completed its third report on the closeout economic rates of return (ERRs), which compares the estimates of a compact’s impact in terms of economic benefits calculated at the outset of a project and the ERR calculated at completion, when costs are known, but benefits are still largely still unknown.<sup>77</sup> Indonesia was one of three

<sup>76</sup> Rose, Sarah and Frank Wiebe. “Focus on Country Ownership: MCC’s Model in Practice.” Center for Global Development. January 2015. (accessed June 2019: <https://www.cgdev.org/sites/default/files/CGD-MCC-Monitor-MCC-10-Focus-Country-Ownership.pdf>)

<sup>77</sup> Ospina, Sandra and Melissa Block. “Report on Closeout ERRs.” Millennium Challenge Corporation. June 21, 2017. (accessed June 2019: <https://www.mcc.gov/resources/doc/report-2016-report-closeout-errs#page-content>)

compacts (along with Ghana II and Georgia II) where data for closeout ERRs were unavailable. For Ghana II and Georgia II, the limited data availability was blamed on the recency of the closeout. For Indonesia, the data was unavailable for reasons unique to that compact. According to MCC, the initial ERR for the Green Prosperity Project was never calculated because the project consisted of grant facilities and programming complementary to grant facilities, so there was an inability to measure the economic impact of the subsequent grants. As for the government procurement project, MCC claimed the lack of availability of data was to blame, but anticipated the data later becoming available to calculate the ERR.

The MCC Compact with Indonesia is unique in terms of scope, design and performance. At \$600M, it is only surpassed in cost by the compacts with Morocco (\$697.5M) and Tanzania (\$698M.) In terms of the areas of focus, it is the only compact with projects focused on nutrition and on greenhouse gas mitigation. The challenges associated with evaluating the performance of the compact are also unique, particularly with the Green Prosperity Project and its lack of any ERR. However, an independent performance evaluation commissioned by the MCC found that with the Green Prosperity Project there was a greater emphasis on making awards than on ensuring that projects funded by awards were appropriately prepared.<sup>78</sup> The MCC Compact Indonesia diverted from MCC principles in several ways and it seems likely that many of these diversions resulted from the initial planning stage, where the projects funded by the compact did not

<sup>78</sup> MCC. "Promoting Green Growth in Indonesia." MCC Evaluation Brief. Millennium Challenge Corporation. November 2018 (accessed June 2019: <https://assets.mcc.gov/content/uploads/evaluation-brief-2018002219601-indonesia-compact-green-growth.pdf>)



address the binding constraints identified by the independent and pre-existing CA developed by the ADB.

### **Philippines Compact**

On September 23, 2011, the governments of the Philippines and the United States signed a \$434 million compact that would focus on governance, opening up the fiscal space and improving rural roads in the Philippines. The largest project of the compact was the Secondary National Roads Project, which focused on improving road infrastructure in Samar and Eastern Samar Provinces, with the aim of reducing transportation costs in an area of the Philippines prone to typhoons. The second largest project, the Kalahi-CIDSS Community-Driven Development Project, was an expansion of an existing World Bank community development program that focused on creating stronger linkages between the local governments and the communities they serve through small grants focused on locally identified development challenges. The third program, which was explored in greater detail in the previous chapter of this thesis on Domestic Resource Mobilization, was the Revenue Administration Reform Project. This program focused on implementing reforms to the Philippines Bureau of Internal Revenue to bring about greater accountability and transparency in Philippines tax collection and revenue generation efforts.<sup>79</sup>

#### ***MCC Philippines Compact – Projects***

**Kalahi-CIDSS Community-Driven Development Project** - \$120,000,000  
(\$124,000,000 disbursed)

**Revenue Administration Reform Project** - \$54,300,000 (\$30,280,930  
disbursed)

**Secondary National Roads Project** - \$214,440,000 (\$199,849,932 disbursed)

<sup>79</sup> “Philippines Compact.” Millennium Challenge Corporation. April 3, 2018 (accessed September 2019.) <https://www.mcc.gov/where-we-work/program/philippines-compact>

The CA that informed the design of the Philippines Compact was guided by the HRV growth diagnostic methodology and was the result of a partnership between the United States Government and the Government of the Philippines, but the MCC was not involved in its development. The Philippines CA was conducted under the auspices of the U.S. Government's Partnership for Growth (PFG) initiative, a partnership between the United States and several countries focused on promoting sustainable and broad-based economic growth, guided by the principles set forth in President Obama's September 2010 Presidential Policy Directive on Global Development.<sup>80</sup>

While this CA process was not managed on the U.S. Government side by the MCC, the methodology was the same and the underlying principles of the effort were alike, with both PFG and the MCC placing country ownership, accountability and economic growth at the forefront of their efforts. This CA identified poor governance (specifically the quality of the regulatory environment, the control of corruption and political stability) and limited fiscal space (insufficient government revenue) as the binding constraints to growth in the Philippines.<sup>81</sup>

The Secondary National Roads Project--the largest project in this compact--addressed the inadequacies of transportation infrastructure in the Philippines, a constraint to growth that has long been identified in previous analyses, including a 2007 Asian Development Bank analysis and a 2011 World Economic Forum Global Competitiveness report that showed the Philippines lagged behind regional competitors on roads and

<sup>80</sup> USAID. "Partnership for Growth." News and Information: Factsheets. USAID. August 4, 2014 (accessed September 2019.) <https://www.usaid.gov/news-information/fact-sheets/partnership-growth>

<sup>81</sup> MCC. "Partnership for Growth: Philippines Constraints Analysis." Joint USG-GPH Technical Team. Millennium Challenge Corporation. June 2, 2011 (accessed September 2019.) [https://assets.mcc.gov/content/uploads/2017/05/Philippines\\_CA\\_withCover.pdf](https://assets.mcc.gov/content/uploads/2017/05/Philippines_CA_withCover.pdf)

transport infrastructure.<sup>82</sup> However, while the CA used for this compact identified road infrastructure as a constraint to growth in the Philippines, it did not identify it as a binding constraint. In fact, the report identified insufficient resourcing, poor government planning and corruption as some of the most compelling factors leading to the inadequacy of the roads, suggesting that addressing the binding constraints of poor governance and limited fiscal space as areas that could ultimately benefit the roads.<sup>83</sup>

It is slightly more difficult to identify a single development challenge or a set of challenges that the second largest project in the compact, the Kalahi-CIDSS Community-Driven Development Project, addressed due to its design as a small-grant making enterprise. However, the program's overriding focus was to improve the socioeconomic situation of citizens by encouraging more responsive local government and empowering communities to address locally identified challenges. Although this program is somewhat unique among MCC projects, as it is an expansion of an existing multilateral development bank program and therefore not designed from its beginning by a joint MCC-compact country team, it does appear to address the binding constraint of governance.

The third and smallest program of the MCC compact in the Philippines is the Revenue Administration Reform Project, which directly addresses the binding constraints of both governance and fiscal space. At \$54.3 million, this project represents less than an eighth of the total compact funds for Philippines, but its impact has been touted at length

<sup>82</sup> ADB. "Philippines: Critical Development Constraints, Mandaluyong." Asian Development Bank. December 2007.  
<https://www.adb.org/publications/philippines-critical-development-constraints>

<sup>83</sup> MCC. "Partnership for Growth: Philippines Constraints Analysis." Joint USG-GPH Technical Team. Millennium Challenge Corporation. June 2, 2011 (accessed September 2019.)  
[https://assets.mcc.gov/content/uploads/2017/05/Philippines\\_CA\\_withCover.pdf](https://assets.mcc.gov/content/uploads/2017/05/Philippines_CA_withCover.pdf)

by MCC which claims that the project has produced over \$300 million in additional annual revenue for the Government of the Philippines, including over \$600 million from one individual who had been evading taxes.<sup>84</sup>

A 2017 MCC impact evaluation measuring the success of the Revenue Administration Reform Project noted factors contributing to the success of the program included high level of support from the Government of the Philippines, including the President, Minister of Finance, and the Commissioner of the Bureau of Internal Revenue.<sup>85</sup> The evaluation also noted that this project represented the first MCC partnership with the International Monetary Fund (IMF), which provided technical assistance for the program. These factors are likely just a few among many that contributed to the success of this particular MCC project, and the strong adherence to addressing the binding constraints identified by the CA are notable for the purposes of this chapter.

### **Chapter 3 Conclusion**

The Millennium Challenge Corporation is a donor agency that employs a novel approach to development challenges that places the promotion of economic growth at the center of its mission and the Constraints Analysis serves as the foundation upon which MCC partners with each country to tackle constraints to help unleash the poverty-fighting power of economic growth. The CAs remain integral to MCC's work and the growth diagnostic framework developed by Hausmann, Rodrik and Velasco has been adopted by

<sup>84</sup> "Philippines Compact." Millennium Challenge Corporation. April 3, 2018 (accessed September 2019.) <https://www.mcc.gov/where-we-work/program/philippines-compact>

<sup>85</sup> "Measuring Results of the Philippines Revenue Administration and Reform Project." Millennium Challenge Corporation. Washington. Accessed June 2019. <https://www.mcc.gov/resources/doc/summary-measuring-results-of-the-philippines-revenue-administration-and-ref>

other donors as an important guide to designing economic growth-focused development programming.

On the whole, MCC's programs have been guided by the CAs and have been designed to address the binding constraints to growth identified in their analysis and MCC's growth-driven mission has generally been at the forefront throughout its body of work. However, policymakers have been tempted on certain compacts and projects to stray from the growth diagnostic framework developed by HRV—a framework specifically designed to remove the temptation of political pressures from program design. While this chapter focused on identifying the usage and adherence to CAs throughout MCC's history, there was not an examination of the effectiveness of compacts that strictly adhered to CAs versus those that did not. Further study on that topic would be helpful in providing a better understanding of MCC's effectiveness in economic growth promotion.

After 15 years of operation, the CAs continue to guide the development of new compacts. Senegal's second compact, the latest compact to be signed into agreement in December 2018, is designed to directly address the first binding constraint identified in the CA: access to electricity. Although it is difficult to try to extrapolate any trends from that particular compact, it does serve as confirmation that the CAs continue to be taken seriously and help guide the process by which MCC works with partner countries to promote growth.

## **Thesis Conclusion**

In Chapter 1, the assessment of U.S. government domestic resource mobilization (DRM) efforts in El Salvador and the Philippines found that investments in DRM are effective and can create a sustainable impact, but the sustainability of this impact is dependent upon the commitment of the partner country. El Salvador's more successful DRM program was supported by a significant commitment of resources from the Government of El Salvador. Although partner country obligations to a development program can be measured in a number of ways outside of providing funds, it is still an important measure of the government's commitment to its success and is particularly so in the case of DRM-focused programming, which targets the fiscal function of the state.

The financial commitment made by the Philippines to its partnership with the United States on DRM was less significant in relative comparison to the El Salvador. Perhaps relatedly, there appeared to be more institutional resistance to the changes sought through this partnership. An additional difference in the two contexts is the much more anti-corruption-focused design of the Philippines program, which could account for much of the institutional resistance to the reforms.

The coordination between U.S. agencies responsible for DRM programming was another key element in the design of an effective partnership. The coordination between USAID and the Department of Treasury in El Salvador was deeper and more carefully designed than that of the MCC and Treasury in the Philippines. There are many factors that could be responsible for this: more effective leadership at the embassy level, the

MCC's lack of an operational history in comparison to USAID, and differing coordination and prioritization at the highest levels of the U.S. executive branch.

In the Chapter 2 analysis of the impact that trade facilitation efforts in Sub-Saharan Africa during the period 2007-2017 had on the logistical performance of companies operating in the region. I was particularly interested in focusing on this region because it both had the most reforms as measured by Doing Business and had the lowest scores on the Logistics Performance Index (LPI) in all categories except one in which South Asia came in slightly lower (Shipments.) I found this interesting because the volume of reforms spoke to a concerted effort of countries in Sub-Saharan Africa to improve the business environment and the low ratings on LPI showed that it was certainly an area in need of improvement. The LPI in the region over the ten-year period studied increased in each category with the exception of Timeliness, which had the same score in 2007 and 2017. These improvements suggested a relationship between the commitment of governments in the region to reform and the improvement in the logistical performance and movement of commerce on ground—a suggestion that was supported by the bivariate correlation used in the analysis which showed a statistically significant relationship between overall Doing Business reforms and improvements in LPI.

However, my hypothesis that reforms that are particularly focused on improving trade facilitation would have a stronger relationship to improvements in LPI was not supported by the analysis. In fact, the strength of the relationship that the Doing Business categories that are more associated with improving the regulatory environment with improvements in LPI was an area identified for further study. However, the strength of

the relationship between reforms in the Trade Across Borders category to improvements to LPI provided support for that hypothesis and is also worth additional study.

In the end, this chapter identified a general relationship between pro-business reforms undertaken by the governments of Sub-Saharan Africa and an improvement of private sector views on the quality of the logistical performance in the region over a period of ten years. It was inconclusive as to whether a specific focus on trade facilitation reforms would have the greatest impact on improving logistical quality but did suggest a relationship between a government's commitment to reform and the improvements in LPI. Whether donor agencies focused on development or NGOs and development experts should place more emphasis on trade facilitation and support partner countries as they attempt to meet their obligations under the Trade Facilitation Agreement is fertile ground for more research.

Finally, the assessment of the Millennium Challenge Corporation (MCC) and its utilization of the Constraints Analysis (CA) framework found that 15 years into operations, the MCC still largely adheres to the core mission of addressing constraints to private sector investment and economic growth in partner countries. The analysis found that policymakers have been occasionally tempted to depart from the constraints-focused program design and let other policy priorities take precedent, with the Indonesia Compact serving as a prime example of an MCC Compact in which program design did not benefit from a strict adherence to addressing constraints.

On the whole, MCC's programs have been guided by the CAs and have been designed to address the binding constraints to growth identified in their analysis and MCC's growth-driven mission has generally been at the forefront throughout its body of



work. This chapter focused on the MCC's adherence to CAs but did not assess the effectiveness of compacts that strictly adhered to CAs versus those that did not. Further study on that topic would be helpful in providing a better understanding of MCCs effectiveness in economic growth promotion.

The CAs and the growth diagnostic framework developed by Hausmann, Rodrik and Velasco that guides the development of the CAs represent a novel approach to development that identified economic growth as the key to combatting global poverty. It also represents a core element of what makes the MCC such a unique development agency that was founded on a recognition that their need to be new approaches to development policy that embraced accountability and leveraged the great resources of the private sector.

This thesis provides a glimpse at some important development concepts that have been gaining support in an era of less available resources from donor government and in particular, how these concepts fit into the U.S. strategy on global development. Because each of these analyses considers case studies, or only assesses one or a few U.S. agencies in each chapter, there are admittedly limits to the conclusions that can be drawn regarding the overall U.S. government strategy on development. Further, this thesis did not thoroughly explore how the U.S. government strategy fits into the global effort and how the United States might be coordinating with other donors. This type of coordination is its own topic worthy of further research and analysis, as there may be complimentary efforts that embrace these concepts and find further efficiencies through specialization of donors and leveraging of additional funds.

The critical importance of coordination is a key theme of all three chapters. If policymakers in the United States are interested in ensuring that development policies are efficient and effective, they must focus more on the interaction (or lack thereof) between U.S. government development agencies and other donors. Chapter 1 showed this most clearly with a key conclusion drawn about the importance of interagency coordination, but the other chapters also suggested that it is a key element of successful development programming. Although the focus of Chapter 2 was placed on the wisdom of focusing on trade facilitation as a development policy, the agencies that would have the most expertise in certain aspects of trade (Office of the U.S. Trade Representative, Customs and Border Protection, Commerce Department, etc.) have very little engagement with development agencies such as USAID and MCC. However, were the United States to prioritize investments in trade facilitation, it would be foolish not to pair that investment with greater emphasis on interagency coordination. In Chapter 3, we learned about the novel approach of the MCC and in particular the HRV growth diagnostic that animates its work. Although this thesis did not explore it, it would be interesting to see what other U.S. development agencies have embraced HRV and incorporated more of an emphasis in addressing constraints to growth.

This thesis began by referencing a number of important multilateral initiatives and conferences to illustrate the scope of the challenge in addressing global poverty. While the focus of this paper is on development concepts that the U.S. Government should consider prioritizing, I think it is just as important that coordination with other country donors and multilateral organizations be prioritized. In this political moment where

resources for development are challenged and criticized, duplicated efforts—or even worse, counteracting efforts—are increasingly unacceptable.

In the end, addressing the challenges of global poverty will require a coordinated effort that embraces modern concepts that reflect the realities of today's global economy. Initiatives such as the UN's Sustainable Development Goals provide a solid foundation for the international cooperation necessary, and multilateral agreements such as the Addis Tax Initiative and the WTO Trade Facilitation Agreement show that donors and partner countries can come together around concepts that encourage poverty-alleviating growth. The United States must be at the forefront of this efforts and the next Administration should work with Congress to ensure that the overall U.S. global development strategy is better suited for the modern world.

## **Curriculum Vitae**

Christopher Michael Sullivan was born on June 10, 1985 in Winchester, Massachusetts.

He has a Bachelor of Arts in Political Science from the University of Georgia. He worked in the United States Senate from 2007-2015, where he focused on foreign policy, trade, and national security issues. He has since worked as a consultant in Washington, DC.