

Improving the Foreign Assistance Framework: Use and Configuration of the Country Categories¹

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This paper was prepared under the auspices of an ad hoc Analysis Improvement Team formed in the Office of the Director of Foreign Assistance (F). The first task undertaken by the team was to reassess the use and utility of country categories under the Foreign Assistance Framework. The paper was issued for comment and then was discussed by a cross-section of F staff. The authors made revisions to the paper and produced a separate Annex (available upon request) that summarizes the key issues raised and their responses. The Analysis Improvement Team offers this paper for further consideration within F. The document consists of the following sections:

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I. Introduction

In the first few months of the new Office of the Director of U.S. Foreign Assistance (F), the country categories were central to the reform process. A new Foreign Assistance Framework (FAF) was issued that contained five priority objectives of U.S. foreign assistance, along with five categories into which countries were placed (The January 2007 version of the FAF is included as a reference in Annex I). Papers were drafted to illustrate the types of programs that would be undertaken for each objective in each country category. F was initially organized into teams according to the country categories, rather than regional teams. During F's inaugural budget build, the FY08 budget, the country categories figured in to the core team discussions. They were used in presentations to the Secretary and OMB in charts which compared the proportion of resources dedicated to each objective in each of the country categories. Similarly, the introduction to the FY08 CBJ highlighted which objectives had the largest shares of resources in each country category (e.g., 63% of the funding for Restrictive countries was in the GJD objective; 44% of the funding for Developing countries and 52% of Transforming country resources were in IIP).

However, mid-way through the FY08 budget build, F was reorganized into regional teams. Since the FY08 CBJ, the country categories have played little or no role in the budget and programming process. In the FY09 CBJ, we do not include the country category labels at all.

This paper will address the following questions: What purpose were the country categories meant to serve? Why have the country categories proven problematic? What sorts of improvements would help? Under what circumstances can the country categories play a useful role? This latter question points to the need for broader changes in the FAF, and for a strategy built around clear strategic goals (Sections V and VI). Section VII summarizes our findings and conclusions.

II. Original Purpose of the Country Categories

The country categories had several specific purposes:

1. The categories recognized that there were different groupings of countries that required different foreign assistance approaches.
2. They were meant to sharpen the focus on results at the country level and ultimately *graduation* from foreign assistance.
3. The categories emphasized a country-based approach to assistance and as such, they were meant to facilitate a defense against earmarks and directives.

More generally, the country categories and the focus on country progress from one category to the next – as exemplified by the emphasis on Spider graphs in the initial core group meetings – were arguably at the heart of aid reform. They were an integral part of a Foreign Assistance Framework centered on country progress. They were meant to

fundamentally change and frame our internal approach to budgeting and programming; and also our discussions with the Hill.²

III. Problems Encountered

Although the categories recognized that there were different groupings of countries, they proved problematic because they were to varying degrees ill-defined. This meant that it was not always transparent why a country was designated in one category and not another. Further, the country categories were meant to guide programming in a country. But only brief, draft operational guidelines were developed, and even those were not widely distributed, much less followed.

Second, they were intended as a tool for describing and measuring country progress. However, it became apparent that few if any countries follow a smooth path from rebuilding to developing to transforming and ultimately sustaining partner status.

As a corollary to the points above, there was neither a process nor a commonly understood set of criteria to consider changing a country's category to account for changing circumstances on the ground. The criteria for moving out of (or into) the rebuilding category remain unclear. Passing the MCC performance criteria did not necessarily result in the MCC eligible countries being labeled as transforming; and policy performance in some transforming countries has deteriorated over time.

Finally, the framework (the FAF), of which the country categories were an integral part, did not adequately recognize that country progress is not the only goal of foreign aid. The ordinary course of events would be to first produce a foreign assistance strategy or concept paper with clear goals, objectives and broad guiding principles for strategic management; and then try to depict that strategy compactly in something like the FAF. For better or worse, F started at the end instead of the beginning. We have had a compact framework, but with no strategy or concept paper behind it. Efforts to write a strategy in F (based on the framework) foundered on uncertainty and disagreement about the goals we were trying to achieve. Some thought our goals had mainly to do with the rows (i.e., the country categories), and with country progress; some thought they had mainly to do with the columns (i.e., achievements against the five objectives); and some thought that there were important goals not represented in either the columns or the rows. It is no wonder that the country categories fell into disuse.

It is important to recognize the Foreign Assistance Framework (FAF) as the initial attempt at setting the parameters and terms in which a "grand bargain" for foreign assistance reform could be made. As the points above illustrate, there were flaws in the design and maintenance of the framework making it a weak intellectual foundation on which to craft such a "grand bargain" (never mind the much analyzed shortcomings of

² This is unfortunately to some extent a matter for speculation and debate, since there has been no policy office in F, and therefore only limited documentation, explanation, and justification – mainly in speeches and testimony, which are inevitably long on rhetoric and short on analysis – of the thinking that went into aid reform.

the tactics of the roll out and outreach associated with the FAF and foreign assistance reform in general).

The following section will discuss each country category in turn, considering the validity and usefulness of the category, and whether and how definitions and indicators can be improved. (Annex II provides more detailed, supporting analysis.) This much would at least help maintain the country categories and report on country progress.

However, even with the recommended adjustments, the usefulness of the country categories is severely limited unless they are seen as part of a broader framework, one that more clearly recognizes that a major portion of foreign aid is NOT primarily aimed at overall country development progress; and unless this framework is backed up by a strategy or concept paper that is clear on goals and guiding principles for achieving those goals. In the next two sections of the paper (V. and VI.) we discuss how to address these issues in ways that would make the country categories much more useful and meaningful. We close with a summary of our conclusions.

IV. Analysis of the Country Categories

Rebuilding Countries

Current definition: State in or emerging from and rebuilding after internal or external conflict.

Original Criteria/Indicators for Identifying Countries in the Category: Essentially a matter of judgment, without apparent reference to objective criteria and indicators.

Relationship to Country Progress:

Rebuilding countries are mostly low-income countries (2006 per capita income below \$1000). Current exceptions include Colombia, Lebanon, Kosovo, and Iraq. At the same time, not all low-income countries are or were rebuilding countries. Because conflict happens in countries of varying income levels it is possible for a country such as Lebanon to move from the rebuilding category into the sustaining partner category.

Recommended Criteria/Indicators for Identifying Countries in the Category:

Indicators of conflict, instability, and weak governance should be used to help identify countries that belong in this category. Examples include the Kauffman/Kraay index for political instability and violence, and indicators of policy performance generated by MCC and by the World Bank. Informed judgment about the feasibility of development progress should also play a major role. Movement out of the rebuilding group should be based on the same indicators and considerations.

Is the category significant for operational purposes?

Yes. The rebuilding category is valid and useful insofar as instability, conflict, and exceptionally weak governance render conventional, medium term “development” programs inappropriate and unlikely to yield results. The implication is that country

strategies and operational plans should be assessed in terms of how well they enhance stability, dampen conflict, improve security, advance reforms, and develop capacity – thereby establishing the foundations for medium-term development programs.

Developing and Transforming Countries

Current definition: *Developing* countries are states with low or lower-middle per capita incomes, which do not meet MCC eligibility criteria including the criterion related to political rights. *Transforming countries* are states with low or lower-middle income that meet MCC eligibility criteria including the criterion for political rights.

Original Criteria/Indicators for Identifying Countries in the Category:

The MCC eligibility and performance criteria were used to distinguish transforming countries from developing countries.

Relationship to Country Progress: Countries in each group span a wide range in terms of levels of per capita income, social indicators, and other measures of level of development. Hence, proximity to sustaining partner status is varied within both the *transforming* group and the *developing* group. Further, there is plenty of movement in the “negative” direction among these groups. Therefore, *they should not be seen as representing distinct “stages of development”*.

Recommended Criteria/Indicators for Identifying Countries in the Category: It has become evident that the distinctions between transforming and developing countries are not robust or stable enough to warrant separate groups. Therefore, the two groups should be merged into one – developing countries (or, “transformational development” countries). It remains important to keep track of policy performance within this group, using both MCC and World Bank information, and to be aware of “good performers” and “weak performers”. Other groupings may also be useful from time to time depending on the issue at hand, e.g. groupings by income level, by regime type, by rate of progress, or by some other indicators. However, none of these examples suggest a distinct category of countries (within the developing group) for general strategic purposes.

Is the category significant for operational purposes? Yes, as long as there is no longer a separate, *transforming* category. The *developing* or *transformational development* countries are at the heart of the vision of helping to build and sustain democratic, well-governed states that respond to the needs of their people and reduce widespread poverty. Policy and strategic guidance aimed at achieving development progress and results is implicitly if not explicitly aimed at this group.³ F needs to develop such guidance. Country progress for the developing group should be measured in terms of economic growth, improvements in political and economic freedom, improvements in social indicators, etc. The end-goal is graduation from *developmental* foreign aid and movement to sustaining partner status, whereupon aid programs (if any) are to be based solely on issues of mutual concern.

³ For example, USAID’s recently approved Economic Growth Strategy.

Sustaining Partner Countries

Current definition: States with upper-middle per capita income (above roughly \$3500 in 2006) for which U.S. support is provided to sustain partnerships, progress, and peace.

Original Criteria/Indicators for Identifying Countries in the Category:

Per capita income (above \$3500).

Recommended Criteria/Indicators for Identifying Countries in the Category:⁴

For the *sustaining partnership* group, per capita income is arguably a sufficient indicator.

However, there is a case for also considering social indicators, as in the UN's Human Development Index, since these are also frequently used to gauge level of development and proximity to "advanced" status.

Further, some countries *below* the per capita income threshold should arguably be considered for sustaining partner status e.g. Thailand (\$3050), Tunisia (\$2970), and Macedonia (\$3070). These considerations should be based on other indicators (e.g. per capita income in Purchasing Power Parity terms, social indicators, and indicators of governance); and on judgments about their advanced level of development and prospects for continued progress.

Relationship to Country Progress:

Sustaining partnership status should be considered as "graduation" from traditional development assistance.

Is the category significant for operational purposes?

Yes. The implication is that country strategies and operational plans should be assessed in terms of how well they enhance and support strategic partnerships on issues of mutual concern.

Restrictive Countries

Current definition: States of concern where there are significant governance issues.

Original Criteria/Indicators for Identifying Countries in the Category: Strictly judgmental, based mainly on governance issues and criteria

Recommended Criteria/Indicators for Identifying Countries in the Category:

The *restrictive* group should continue to be identified based on informed judgment. The sorts of indicators used to identify the other groups have no apparent role to play.

Relationship to Country Progress:

⁴ See Annex II, pp 14-15 for more detailed analysis and discussion, including justification for focusing only on per capita income and for considering sustaining partner countries as graduates where developmental foreign aid is concerned.

Restrictive countries cover a wide span in terms of level of development, with per capita incomes ranging from \$340 to nearly \$7500. Progress has to do with overcoming the governance issues that stand in the way of a more conventional assistance relationship. Once those issues are resolved, a restrictive country might move to any of the other country categories depending on its circumstances.

Is the category significant for operational purposes?

Yes. The restrictive category is valid and useful in so far as the types of programs for other country groups are inappropriate and unlikely to yield results. Assistance should be viewed as a tool for addressing the issue of concern which puts the country in this category. In many countries, this will mean focusing on the demand side of governance and reform (civil society).

V. Two Broader Adjustments Affecting the Usefulness of the Country Categories and the FAF

The preceding discussion points to several improvements that would address the immediate issues with the country categories, making them a more useful tool for measuring country progress and as the basis for developing operational guidelines and principles for programming toward the goal of country progress.

However, even with these fixes the country categories alone—and an FAF based on them—are not sufficient for strategic planning, budgeting, programming, and evaluation. Not all of foreign aid is motivated by a primary concern with development progress at the country level and movement towards graduation from developmental foreign aid.

First, there are a limited number of “key countries” where our aid programs are driven mainly by major foreign policy concerns that stand apart from development – concerns such as supporting key allies in the GWOT, the search for peace in the Middle-East, and peace and regional stability in Africa and elsewhere. To varying degrees our aid programs may be oriented towards *overall country progress* in these countries – to a very high degree in Iraq and Afghanistan; much less so in Israel and Colombia. In all these cases, however, specific foreign policy imperatives – and not simply whether and how we can achieve the greatest development results – play a major role in our decisions about aid levels and/or program content.

Second, we need to recognize that a great deal of aid goes for global and transnational issues and other special concerns that are important in and of themselves, independent of their links – however strong or weak – to overall development progress at the country level. Some of this is already evident in the FAF:

- a substantial portion of assistance under the humanitarian and peace and security headings is for self-standing concerns that are distinct from (though arguably linked to) development progress.
- Further, there is a row for global and regional programs in the framework; and

- the sustaining partner group is increasingly seen as having programs addressing issues of mutual concern rather than further development progress.

However, a number of special concerns – e.g. infectious diseases, global environmental issues, support for specific trade agreements, trafficking in persons, regional development aimed at counter-narcotics, and assorted other earmarks, directives, and initiatives – remain buried in the framework as if they were primarily motivated and governed by development concerns and criteria relating to overall country progress towards graduation. They are not⁵.

These two distinctions – key countries with foreign policy driven programs and key concerns – have been recognized both internally and externally:

- They were quickly recognized in F (by the Chief Operating Officer and G/F at least) as significant issues for the framework during the first six months of F’s existence, in the context of the FY08 budget build. G/F drafted a proposal for dealing with each issue.
- They have been recognized in leading external studies of aid reform over the past year (Brainard, HELP, Dam, and Lancaster)
- They were recognized in USAID’s White Paper (2004) and operationalized in USAID’s Policy Framework for Bilateral Foreign Aid (2006) prior to aid reform.

The two distinctions can be visualized and depicted in the FAF by introducing:

- a “shaded portion” in each row for “key countries” (e.g. for Afghanistan and Iraq within Rebuilding; and for Egypt and Jordan within Developing)
- a “shaded portion” in each column for resources, programs, and activities that address global and transnational issues and other special concerns.

With this adjustment, the “unshaded” areas in the FAF would be for resources, programs, and activities aimed primarily at moving countries forward. The sorts of approaches used in the initial months of F to focus on country progress would be appropriate for those resources and programs. Resources in the shaded areas should be governed by guiding principles that acknowledge the purposes those resources serve, and the results they are intended to achieve. In some cases they might include broad developmental considerations (economic growth in Egypt), but with heavy allowance for other foreign policy concerns.

VI. The Country Categories and Strategic Management of Foreign Aid

As discussed in Section III, the ordinary course of events would be to first produce a foreign assistance strategy or concept paper with clear goals, objectives and guiding principles for strategic management; and then try to depict all that compactly in

⁵ We do not claim that ALL earmarks, directives, and initiatives represent special concerns.

something like the FAF. We have a compact framework, but with no strategy behind it, and with considerable uncertainty and lack of clarity about the primary goals for foreign aid.

Simply adjusting the existing framework along the lines suggested above will not by itself make much difference in improving the utility of the FAF and the country categories as a tool for strategic resource management. The goals we are supposed to be managing towards would remain unclear, as would the resources directed at those goals, and the guiding principles for achieving those goals. The country categories would serve mainly as a broad reporting or story-telling device.

However, the revisions suggested above point to a set of clear, distinct strategic goals. These goals make good use of the country categories, while also acknowledging the variety of concerns (beyond overall country development progress) that foreign aid addresses.

They include:

- Overall country progress (usually towards developing country status) in *rebuilding* countries;
- Overall country progress (towards sustaining partner status) in *developing* countries;⁶
- Support for key strategic allies (around a dozen countries);
- Humanitarian assistance to save lives and alleviate suffering;⁷
- Progress on global and transnational issues and other special concerns.⁸

How do these goals enhance the usefulness of the country categories? In essence, neither the country categories, nor the 5 objectives are the main unit of analysis for discussing budget tradeoffs. Instead, the five goals listed above become the focus of strategic budget tradeoffs. The goals help to clarify which of our resources are we truly allocating against our country progress goals, and which of our resources are we allocating, programming, and judging performance against other criteria. The country categories remain a tool for focusing on results and *graduation* from developmental foreign aid (the first two goals above). The level of resources and principles for prioritizing amongst countries in the third goal are dictated by foreign policy judgments, and performance is judged both in terms of achieving foreign policy goals and in terms of country progress, where appropriate. Programs in the sustaining partner group and the restrictive group would fall under the fourth and fifth goals, but not the first three.

A strategy based on these goals could be compactly represented by the FAF with the adjustments recommended in this paper. More importantly, a strategy based on these goals fits well both with the afore-mentioned external studies of how to manage foreign

⁶ i.e. transformational development or “long-term” development.

⁷ In countries in any category.

⁸ Also in countries in any category. Our programs in sustaining partner and restrictive countries would be ONLY for the last two goals. Therefore, looking at our current non-humanitarian programs in those countries provides a good test for identifying activities that belong under the fifth goal.

aid strategically; and also with the framework that was conceived and operationalized in USAID prior to aid reform. There is ample evidence that it is both sensible and doable.

With these goals, F could more readily produce strategic guidelines for resources and countries associated with each of the country categories. F could then more readily discuss and formulate country strategies, reducing needless debate about the links and tensions between development and other important foreign policy concerns.

Finally, these goals fit well with the Secretary's overarching goal for transformational diplomacy. In particular, the third and fifth goals more explicitly acknowledge the last phrase in that goal, "countries...that conduct themselves responsibly in the international system". Both of those goals point to cooperation on issues of international concern. A strategy based on these goals would also better support the goals of aid reform, simultaneously bringing greater strategic focus and coherence to foreign aid while also aligning assistance more closely with foreign policy priorities.

VII. Conclusions

This paper makes a number of suggestions and recommendations for improving the configuration and usefulness of the country categories.

On a relatively narrow and specific level we suggest:

- Using indicators of conflict, instability and (weak) governance for the *rebuilding* group, along with judgments about the (in)feasibility of medium-term development programs.
- Combining the *developing* and *transforming* categories, while still paying attention to policy performance within the group, using World Bank as well as MCC indicators. Other sub-groupings within this large group (e.g. by per capita income, by regime type, by rate of progress) might also be useful from time to time for one or another specific purpose.
- Sticking with per capita income as the main criterion for the *sustaining partner* group, pending further analysis of the potential usefulness of other indicators. We should be open to including countries with per capita incomes *below* the threshold in this group (i.e. "early graduation" from *developmental* aid), based on informed judgments about their level of development and their prospects.
- Sticking with the *restrictive* group as currently defined and selected.

With these adjustments we can more readily use the country categories to discuss country progress and describe in broad terms our approach to foreign aid.⁹

However, even with these adjustments the usefulness of the country categories for planning, programming, and results reporting would remain severely limited without several broader adjustments.

⁹ For instance, see "Progress in DFA Recipient Countries", F/GF draft prepared for the 2009 CBJ.

In particular we suggest *two adjustments to the FAF* – recognition of a limited number of “key countries” (with large programs driven by major foreign policy concerns other than development progress); and recognition of “key concerns” (including global and transnational issues).

Further, we suggest *five core strategic goals* that would make the country categories (and the FAF more generally) much more useful for strategic management. These include (stated in capsule fashion):

- Overall Progress in Rebuilding Countries
- Overall Progress in Developing Countries
- Support for Strategic Allies
- Humanitarian Assistance
- Address Global and Transnational Issues and other Special Concerns.

With these broader adjustments the country categories -- and the FAF more generally -- could become much more useful for strategic management. In the absence of these broader adjustments they are useful mainly as a way to organize reporting.

ANNEX 1—The Summary Foreign Assistance Framework

AS OF JANUARY 23, 2007

FOREIGN ASSISTANCE FRAMEWORK

Goal		"To help build and sustain democratic, well-governed states that respond to the needs of their people, reduce widespread poverty and conduct themselves responsibly in the international system."							
Objectives		Peace and Security	Governing Justly and Democratically	Investing in People	Economic Growth	Humanitarian Assistance	End Goal of US Foreign Assistance	Graduation Trajectory	
Accounts within State/USAID		PMP, TI, IMET, ESF, INCLE, NADR, PKO, ACI, PSA, SEED	DA, TI, SEED, PSA, DF, ESF, INCLE, IO&P, ACI	DA, CSH, ESF, IDFA, IO&P, PSA, SEED, GHAI, ACI, Title II	DA, ESF, SEED, PSA, IO&P, ACI, Title II	IDFA, MRA, ERMA, ACI, Title II			
Foreign Assistance Program Areas		<ul style="list-style-type: none"> > Counter Terrorism > Combating WMD > Stabilization Operations and Defense Reform > Counternarcotics > Transnational Crime > Conflict Mitigation and Response 	<ul style="list-style-type: none"> > Rule of Law and Human Rights > Good Governance > Political Competition and Consensus-Building > Civil Society 	<ul style="list-style-type: none"> > Health > Education > Social Services and Protection for Vulnerable Populations 	<ul style="list-style-type: none"> > Macroeconomic Foundation for Growth > Trade and Investment > Financial Sector > Infrastructure > Agriculture > Private Sector Competitiveness > Economic Opportunity > Environment 	<ul style="list-style-type: none"> > Protection, Assistance and Solutions > Disaster Readiness > Migration Management 			
Category Definition		Other USG Agency Contributions							
Rebuilding Countries	States in or emerging from and rebuilding after internal or external conflict.	Prevent or mitigate state failure and/or violent conflict.	Assist in creating and/or stabilizing a legitimate and democratic government and a supportive environment for civil society and media.	Start or restart the delivery of critical social services, including health and educational facilities, and begin building or rebuilding institutional capacity.	Assist in the construction or reconstruction of key internal infrastructure and market mechanisms to stabilize the economy.	Address immediate needs of refugee, displaced, and other affected groups.	Stable environment for good governance, increased availability of essential social services, and initial progress to create policies and institutions upon which future progress will rest.	Advance to the Developing or Transforming Category.	
Developing Countries	States with low or lower-middle income, not yet meeting MCC performance criteria, and the criterion related to political rights.	Address key remaining challenges to security and law enforcement.	Support policies and programs that accelerate and strengthen public institutions and the creation of a more vibrant local government, civil society and media.	Encourage social policies that deepen the ability of institutions to establish appropriate roles for the public and private sector in service delivery.	Encourage economic policies and strengthen institutional capacity to promote broad-based growth.	Encourage reduced need for future HA by introducing prevention and mitigation strategies, while continuing to address emergency needs.	Continued progress in expanding and deepening democracy, strengthening public and private institutions, and supporting policies that promote economic growth and poverty reduction.	Advance to the Transforming Category.	
Transforming Countries	States with low or lower-middle income, meeting MCC performance criteria, and the criterion related to political rights.	Nurture progress toward partnerships on security and law enforcement.	Provide limited resources and technical assistance to reinforce democratic institutions.	Provide financial resources and limited technical assistance to sustain improved livelihoods.	Provide financial resources and technical assistance to promote broad-based growth.	Address emergency needs on a short-term basis, as necessary.	Government, civil society and private sector institutions capable of sustaining development progress.	Advance to the Sustaining Partnership Category or graduate from foreign assistance.	
Sustaining Partnership Countries	States with upper-middle income or greater for which U.S. support is provided to sustain partnerships, progress, and peace.	Support strategic partnerships addressing security, CT, WMD, and counter-narcotics.	Address issues of mutual interest.	Address issues of mutual interest.	Create and promote sustained partnerships on trade and investment.	Address emergency needs on a short-term basis, as necessary.	Continued partnership as strategically appropriate where U.S. support is necessary to maintain progress and peace.	Continue partnership or graduate from foreign assistance.	
Restrictive Countries	States of concern where there are significant governance issues.	Prevent the acquisition/proliferation of WMD, support CT and counter-narcotics.	Foster effective democracy and responsible sovereignty. Create local capacity for fortification of civil society and path to democratic governance.	Address humanitarian needs.	Promote a market-based economy.	Address emergency needs on a short-term basis, as necessary.	Civil society empowered to demand more effective democracies and states respectful of human dignity, accountable to their citizens, and responsible towards their neighbors.	Advance to other relevant foreign assistance category.	
Global or Regional	Activities that advance the five objectives, transcend a single country's borders, and are addressed outside a country strategy.						Achievement of foreign assistance goal and objectives.	Determined based on criteria specific to the global or regional objective.	

AS OF JANUARY 23, 2007

Annex II: Country Categories, Country Progress, and “Graduation” in the FAF – Analysis

We examine each category in turn, with an eye to whether the category represents a distinct stage of development; and then the more general issue of definition, criteria, and indicators for each group. We then look at how to approach “country progress” and “graduation”.

A. Restrictive Countries – these are countries where the opportunities for government-to-government cooperation around foreign aid are severely limited owing to ideology and governance considerations.

Is this a stage of development? Clearly not, since countries ranging from least developed to relatively advanced can belong to this group. The distinctive characteristics of “restrictive” have essentially to do with political orientation, and not with economic or social development. Similarly, countries move into or out of this group when the politics of the country fundamentally change. Foreign aid often aims at supporting positive change.

There is not much of a role for common indicators of country progress. It is arguably neither feasible nor desirable for quantitative indicators to play a significant role in identifying such countries. Similarly, there is little if any role for indicators in deciding when countries move into or out of this group. The criteria are essentially matters of informed judgment, as are appraisals of “progress”.¹⁰

“Graduation” is not an apt term to describe movement out of this group.

- Insofar as restrictive status is not a “stage” of development, graduation is not an appropriate term.
- Countries move into and out of this group based on major changes in political orientation – changes that are reversible. Graduation typically connotes irreversible movement in a positive direction – once a college or high school graduate, always a college or high school graduate.

These considerations (not a stage of development; very limited role for common indicators; “graduation” is of limited applicability) do not detract from the validity and usefulness of this category. Placement in the restrictive category has clear and distinct implications for how we approach planning, budgeting, programming, target-setting, and results reporting. We can judge when countries move out of the group, and we can celebrate such movement as significant progress in terms “transformational diplomacy.”

¹⁰ More could be said about the limitation of indicators. For instance, the countries in this group arguably have very little in common with one another, except for political regimes that are in some sense repugnant. So, the role of common progress indicators is correspondingly limited (in contrast to some of the other country categories). Further, country “progress” is not likely to be smooth and steady, but instead may often be discrete and discontinuous (e.g. regime change).

B. Rebuilding Countries -- These are countries where political and economic instability stemming from conflict and weak governance constrain the government's ability to move forward on transformational development.¹¹

Is this a stage of development? On the affirmative side, the definition clearly highlights “preconditions” for development – problems that must be addressed *before* development progress is feasible. That makes it seem like a stage. On the negative side:

- Not all very poor countries have been constrained by conflict and instability (e.g. Malawi, Tanzania, and Zambia), though most are vulnerable since low-incomes and weak institutions tend to go together.
- Some rebuilding “countries” (Colombia, Kosovo, Iraq, Lebanon and [hypothetically] Sri Lanka) are not poor or backward in a developmental sense.
- If the rebuilding category were the “first” or “lowest” stage of development then over time the size of the group would go from larger to smaller. That hasn't happened. Instead, various countries – mainly but not exclusively poor countries – move into and out of and sometimes back into the rebuilding category.¹²

There is ample room for using indicators to help place countries and report on progress. The key factors are conflict, instability, and weak governance. We have indicators for these that have the desirable properties -- externally generated, publicly available, published annually, and suitable for comparisons across countries and over time.

However, informed judgment should play a major role. For purposes of programming foreign aid, a primary consideration in rebuilding countries is “constraints on the ability to move forward on transformational development.” The extent to which those constraints are strictly binding versus seriously problematic versus mildly problematic is a matter of judgment – informed but not dictated by indicators. Further, available indicators are subject to significant lags, while the underlying factors can change quickly (a peace treaty, a new government, etc.). Consequently, decisions about placing countries in the rebuilding group or not should ultimately be a matter of informed judgment about the feasibility of achieving medium-term development results -- particularly judgments by those working in-country.¹³

“Graduation” is not an apt term to describe movement out of this group.

- Insofar as rebuilding status is not a “stage” of development, graduation is not an appropriate term.
- Countries move into and out of this group based on trends in conflict, stability, and quality of governance – trends that are reversible.¹⁴

¹¹ There is some circularity -- often vicious -- in these terms, and precise definitions and diagnoses are elusive. Nonetheless, the category is a valid and important one. A recent contribution – “The Causes of Civil War” – emphasizes the causal role of weak institutions, rather than poverty per se. (World Bank Policy Research Working Paper #4254, June 2007)

¹² Indeed, Sri Lanka and Lebanon – neither developing – have been candidates for rebuilding status.

¹³ This approach worked reasonably well in USAID efforts to identify “fragile states” during 2004-06.

¹⁴ Paul Collier has highlighted the significant odds of relapse in post-conflict countries.

C. Sustaining Partnership Countries – These are countries where “mutual interests on specific issues drive the [foreign aid] agenda”. Partnership is NOT predicated on [development] need or performance. Such countries are identified using a threshold value for per capita income, currently at \$3595 for 2006 per capita income.

Is this a stage of development? Arguably yes, insofar as the focus for foreign aid is exclusively on issues of mutual interests, without attention to development criteria or results. Countries in the Sustaining Partner group can reasonably be considered “advanced” from the standpoint of development and developmental foreign aid. While development challenges may remain, such countries are judged to be capable (from the standpoint of financial and human resources, access to international capital markets, and other resource considerations) of sustaining further progress on their own. Political will and commitment may stand in the way of continued development progress, but resource considerations do not.

Indicators already play a predominant role in identifying countries that belong in this group, namely per capita income. The issue is whether other indicators should be brought to bear:

- *It can be convincingly argued that per capita income is a sufficient indicator, particularly in an era of globalization where currencies are convertible and capital, technology, information, etc. flow readily across borders. Looking at countries above the \$3595 per capita income threshold, it is hard to identify a country for which development progress is dependent on foreign aid. Both the MCC and IBRD find per capita income a sufficient indicator for identifying advanced developing countries.*¹⁵
- *The most defensible alternative would be to consider social indicators as well, as in the “human development index”, which is really a country development index. Indicators such as fertility, infant mortality, life expectancy, literacy, etc. shed light on a country’s level of development, along with per capita income.*
- *There is a strong case to be made that deficiencies in income distribution and/or governance should NOT justify continued developmental foreign aid once per capita income or other thresholds have been met. Given adequate resources as indicated by per capita income, the main issue becomes one of political will. Foreign aid should arguably not substitute or compensate for shortcomings in political will in advanced developing countries with adequate domestic resources.*¹⁶

¹⁵ It would be reasonable to consider per capita income in purchasing power parity (PPP) terms as well, to provide additional information on resource availability.

¹⁶ The following considerations underlie the claim that for higher-income countries, deficiencies in governance should NOT be a rationale for continued aid, since these deficiencies are more likely to reflect deficiencies in political will than resource scarcity. Good governance (as represented by institutional performance) arguably depends on two factors – political will or “commitment”; and resources (human, financial, institutional, technological, infrastructure, etc.). Some aspects of governance are more resource intensive than others. For instance, controlling inflation is mostly a matter of political will, and poor countries can reasonably be held responsible for this. Similarly, democracy and freedom are essentially

- However, *in some cases, lingering development problems in advanced countries can be legitimately considered issues of mutual concern.* Possible examples include poverty and income distribution in Mexico or governance in Russia. Including such countries in the sustaining partnership group still permits foreign aid to address development issues if these issues are important to U.S. interests.

So far the discussion has to do with per capita income as a “sufficient” indicator for sustaining partner status. There is also the issue *whether countries with per capita incomes below the threshold should be considered as eligible for sustaining partner status.* For instance, Thailand, Tunisia, and Macedonia all fall below the threshold. Yet they are arguably sufficiently advanced in terms of development and resource availability that U.S. foreign aid (if any) should be justified solely on the basis of mutual interests and not on development need or performance. This suggests a role for informed judgment for countries with per capita incomes *below* the threshold. For countries *above* the threshold, inclusion in the sustaining partner group should be indicator driven, to ensure discipline and avoid the temptation to prolong *developmental* foreign aid.

Once countries are in the Sustaining Partnership Group, *the scope for indicators of progress depends on the issues of mutual concern that motivate a continued aid program.*

Graduation is an apt term to describe movement into this group. A country in the sustaining partner group should be considered a graduate where *developmental* foreign aid is concerned.

Graduation is NOT an apt term to describe movement out of this group, i.e. cessation of all foreign aid. Whether countries in this group receive aid depends on issues of mutual interest, which can come and go independent of further development progress. As the cases of Ireland and Greece demonstrate, even very advanced countries might receive foreign aid if mutual interests warrant.

On the other hand, there arguably *should be graduation criteria specific to each issue of mutual concern.* These criteria would signal when success has been achieved, and when aid for that concern should stop. However this would not necessarily represent graduation for the country as a whole.

issues of political will. In contrast, effective rule of law, protection of property rights, effective regulation and provision of public services require resources as well as political will. For this reason, governance scores (e.g. Economic Freedom scores and the Kauffman/Kraay governance indicators) are significantly but not perfectly correlated with per capita income. When MCC, IDA, USAID and others use governance indicators to gauge political will and commitment, they are careful to group countries according to per capita income, to control for the influence of resource availability and thereby compare countries mainly on political commitment. And, they often make an effort to focus on aspects of governance that are not resource intensive. On this basis we argue that deficiencies in governance in sustaining partner countries should NOT be a rationale for continued aid, since these deficiencies are likely to reflect deficiencies in political will rather than resource scarcity.

D. Transforming Countries – these are countries (with per capita income below the threshold for sustaining partner status) which are relatively good policy performers, as determined by MCC performance criteria and with special attention to political rights.

Should transforming status be considered a stage of development? It is hard to marshal a convincing argument that good policy performance (as measured by MCA, or by the World Bank) is a stage of development. There are a number of compelling arguments that transforming status should NOT be considered a stage of development:¹⁷

- As OMB has pointed out, countries in the transforming group cover a wide range of per capita incomes. They also cover a wide range of scores on the human development index (HDI), a reasonable proxy for level of development. Many have very low incomes and HDI scores and are a very long way from sustaining partner status.
- In particular, the low-income countries in the transforming group are *further* from sustaining partner status than many of the countries in the developing group.
- Further, many countries in the developing group have moved or will move to sustaining partner status without ever qualifying for the transforming group.
- As a general proposition, when donors such as MCA, USAID, or the World Bank try to measure policy performance, they focus on isolating political will and commitment – which can be strong or weak at *any* level of development.
- Expressed differently, donors aim to avoid measures or approaches to selectivity that favor more advanced countries relative to poorer countries. Thus, “least-developed” countries can qualify for MCA compacts (e.g. Madagascar, Mali, Benin, Burkina Faso, Gambia, Lesotho, Mozambique, Vanuatu and Tanzania) while much more advanced countries do not (Guatemala, Colombia, Jamaica).
- Further, policy performance can readily fluctuate. A recent paper discussing FAF adjustments identified seven countries that no longer meet the policy criteria for transforming status. As discussed above, there should ideally be a fair degree of “irreversibility” where “stages of development” are concerned.
- Growth performance has NOT been distinctly better in transforming countries compared to developing countries. Growth has been sluggish to mediocre in Bolivia, Honduras, Madagascar, El Salvador, Benin, East Timor, Vanuatu, Mali, and Brazil.
- While policy performance is good in transforming countries, institutional capacity and human resource development remain relatively weak in the lower-income countries in the group. These countries remain relatively less developed.¹⁸

The transforming category is mainly useful and valid insofar as it identifies a subset of *developing* countries, those with relatively good policy performance. As with MCA, IBRD, and USAID, this should be a very important consideration for an office such as F that is concerned with allocating foreign aid to achieve development results and support

¹⁷For more detail see “Misconceptions Surrounding the Millennium Challenge Account”, October 2007, available at www.egworkshop2007.net/proceedings.htm, Session 25.

¹⁸Part of the confusion and misunderstanding about links between policy performance and institutional capabilities revolve around the discussion in the prior long footnote.

country progress. In any case, the transforming category does not signal a distinct stage of development calling for sharply different approaches to achieving development results.

Indicators already play a predominant role in identifying countries with good policy performance, namely MCA indicators. The issue is whether other indicators should be brought to bear:

- The World Bank’s Country Policy and Institutional Assessments are now published for IDA eligible countries, and providing valuable and useful perspectives on some sixteen criteria within the broad rubrics of economic management, structural policies, policies for social inclusion, and public sector management and institutions. While there are good reasons for MCC to follow their particular approach, *there is no good reason for F not to consider the CPIA scores in identifying good performers.*
- *Using CPIA scores along with MCC hurdles results would also help stabilize the group of good performers.* Currently, a country can fall out of the transforming group based on small changes in *relative performance* with respect to a single hurdle.
- Despite the current methodology, *the correspondence between transforming countries and MCA recipients is only partial.* The transforming group includes some countries not listed as eligible for compacts (India, Thailand); includes a number of countries that do not and will not receive compact funding; and excludes some countries that do have compacts but are placed in the developing group because of the political rights criterion.¹⁹
- Indeed, *the rationale for the political rights criterion is unclear*, partly because the rationale for the transforming category is less than clear. If such countries received special treatment of one sort or another, the argument for the political rights criterion might be stronger.

“Graduation” is not an apt term to describe movement into the transforming group.

- Insofar as transforming status is not a “stage” of development – for reasons elaborated above -- graduation is not an appropriate term.
- Countries move into and out of this group based on trends in policy performance reflecting political will and commitment -- trends that are reversible.
- Attaining transforming status is neither necessary nor sufficient for accessing resources through an MCC compact.
- Policy performance in a significant number of MCA eligible countries has faltered over the past several years, suggesting movement back to the developing group.

¹⁹ Since the correspondence between transforming status and MCC programs is only partial, the question of the role of USAID in countries with MCC compacts is its own separate issue

E. Developing Countries – These are countries that have per capita incomes below the threshold for sustaining partner status and do not meet the criteria for transforming or rebuilding status. They are essentially a residual – the countries that remain once the rebuilding and transforming countries have been identified.

Should developing status be considered a stage of development? Insofar as rebuilding and transforming countries should not be considered at a distinct stage of development, neither should the developing group. There is enormous heterogeneity in this group. Countries range from some of the poorest and most backward to some that might well merit sustaining partner status (e.g. Tunisia and Macedonia). Some are considered good or very good policy performers, despite not qualifying for the transforming group. Some are prone to conflict and instability serious enough to merit rebuilding status. Countries can readily move back and forth between the developing group and the rebuilding or transforming groups.

Insofar as indicators play a significant role in identifying rebuilding, transforming, and sustaining partner countries, they identify the countries that remain in the developing group.

As discussed earlier, movement from rebuilding to developing should be considered a major positive step; but it should not be considered “graduation.” There is an established tendency towards “relapse” where conflict and civil war are concerned.

Summary Findings and Recommendations for Reporting on Country Progress and Graduation

Graduation: The preceding analysis concludes that for the FAF, *only the sustaining partner group represents a distinct stage of development.* These countries can be considered “advanced developing countries”. Similarly, *only movement into the sustaining partner group* -- from the transforming, developing, or even the rebuilding group (possibly Colombia or Kosovo) – *merits the term “graduation”.* Countries in the sustaining partner group should be considered graduates where *developmental* foreign aid is concerned – a significant and lasting achievement. However, they remain eligible for foreign aid focused on *issues of mutual concern.* (We need to better recognize that countries in other categories also receive foreign aid directed at issues of mutual concern.)

Indicators: F should expand and improve the use of indicators for identifying *rebuilding* countries. Informed judgment (about the feasibility of achieving medium-term development results) should also play a role (along with indicators) in identifying *rebuilding* countries. For *developing* countries, F should expand and improve the list of indicators used to characterize policy performance and to single out good performers. F should continue to use per capita income to identify *sustaining partner* countries, while considering the pros and cons of other indicators of advanced development status and (non-) need for foreign aid. *Restrictive* countries should be identified based on informed judgment.

Reporting on Country Progress: In reporting on country progress, movements from one group to another should be noted – particularly movement into the sustaining partner group. The other groups (rebuilding, developing, restrictive) do NOT represent distinct stages of development through which countries pass going only or even mainly in one direction. Therefore this kind of movement should be noted and celebrated, but should not be the sole criterion for judging country progress.

Instead, we should report on country progress in terms of the Secretary’s vision statement – “Helping to build and sustain democratic, well-governed states that respond to the needs of their people, reduce widespread poverty, and conduct themselves responsibly in the international system.” This suggests a focus on (depending on the country category):

- Indicators of democracy (readily available) – both levels (how many countries are “free” or “partially free”) and trends (how many countries are showing improvements over time)
- Other indicators of good governance, e.g. the Kauffman/Kraay indicators, including the indicators of political instability and conflict. Also, indicators of economic freedom (Heritage and/or Cato) and support for markets (Doing Business).
- Indicators of economic progress, both levels (per capita income) and improvements (economic growth rates).
- Indicators of poverty reduction and increased social well being (health, education, women in development), both levels and trends. This allows us to include the MDGs in our reporting, demonstrating our interest [but not our sole interest] in them.
- Indicators of fruitful cooperation and progress on issues of mutual concern, e.g. infectious diseases, many concerns under Peace and Security, Humanitarian Aid, trade agreements, global environmental issues (biodiversity, climate change), etc.
- More general indicators or judgments about whether countries “conduct themselves responsibly in the international system”.

We can report on these indicators by country category within the FAF, but obviously with varying emphases depending on the group.²⁰ For instance, the last bullet is most relevant to the restrictive group. The most relevant indicators for rebuilding countries have to do with governance and instability. The first four bullets are most relevant to developing countries. The fifth is very relevant to sustaining partner countries, *but also to countries in other groups, as issues of mutual concern arise in those countries.*

In addition, for “key countries” where we have exceptionally large aid programs on the basis of significant foreign policy concerns (GWOT, Mid-East Peace, Narcotics, major Conflict and Humanitarian concerns, etc.) we should report on progress on a country specific basis -- in terms of the goals and concerns that motivate the exceptionally large aid program in each case.

²⁰ For a concise example pertaining to rebuilding and developing countries, see the two-pager, “Progress in DFA Recipient Countries” prepared in F/GF for the 2009 CBJ