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MCA: Rewarding Open Markets

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In a new approach to foreign aid, Congress has approved \$1 billion for the Millennium Challenge Account (MCA) for fiscal year 2004. President Bush has stated that the MCA will “reward nations that have more open markets.” To accomplish the President’s goal, the Millennium Challenge Corporation (MCC) should focus on each candidate country’s progress toward more open markets. The Heritage Foundation’s *Index of Economic Freedom* tracks precisely such progress.

Using the *Index* as a guide, the MCC could identify which candidate countries have been working hardest toward President Bush’s goal. The *Index* measures economic freedom by examining 10 factors: trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and informal market activity. As the *Index of Economic Freedom* has demonstrated for the past 10 years, countries that open their markets have higher GDP per capita. (See Chart 1.)

The MCC recently designated 63 countries as potential recipients of MCA grants. Table 1 shows the performance of the 49 of these 63 countries that are covered by the *Index*. Using *Index* data, the table divides the 49 countries into quartiles based on the improvement in their levels of economic freedom over the past four years. Within each quartile, countries are listed according to degree of improvement, in descending order: Countries in the first quartile

are progressing fastest toward economic freedom and would therefore benefit most from the MCA. Conversely, countries in the fourth quartile have improved the least and, measured against the President’s goal, are the least deserving of MCA grants.

These two groups have strikingly different experiences in escaping poverty. The countries in the top quartile have slightly more than six times as much GDP growth over the past 10 years as those in the

bottom quartile. Consistent with the President’s mission, they are likely to move beyond their current dependence on aid.

For instance, Cape Verde’s level of economic freedom has steadily increased since 2000, directly contributing to Cape Verde’s achieving

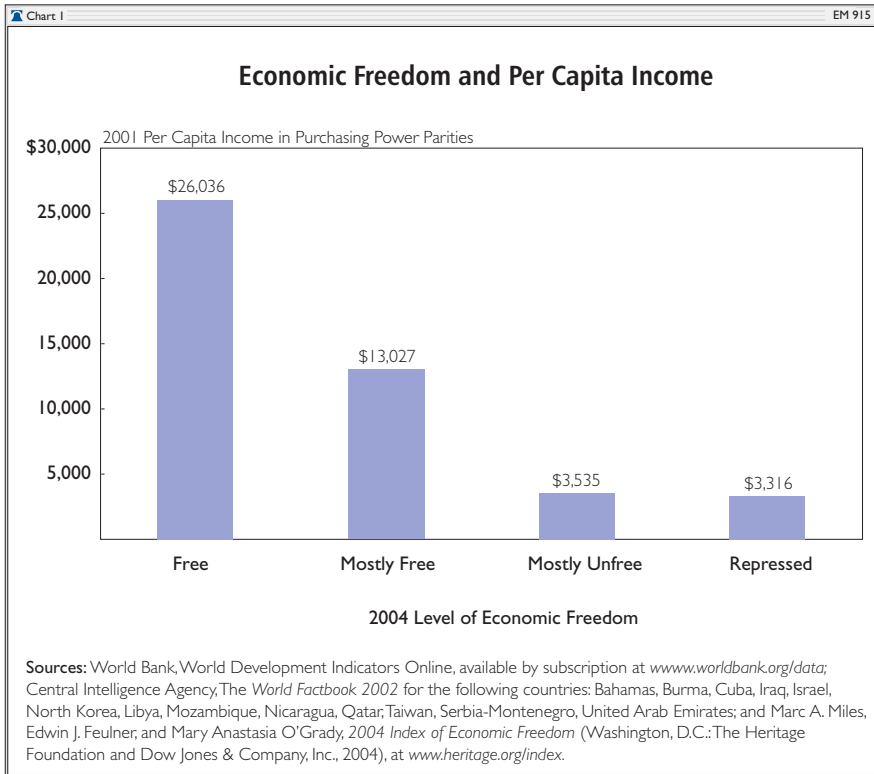
a higher rate of economic growth than most other countries in the table. The government plans to continue this progress by privatizing the remaining state-owned companies, reducing the corporate income tax rate, and implementing other measures. On the other hand, Bolivia has failed to move steadily toward economic prosperity. As the table demonstrates, Bolivia’s poor record in economic freedom is associated with plummeting economic growth.

This paper, in its entirety, can be found at:
www.heritage.org/research/tradeandforeignaid/em915.cfm

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When selecting the countries to receive MCA grants this year, the MCC Board should look no further than the top of this table. The countries chosen this year will set a standard for years to come. Economics, not politics, should determine how the MCA carries out its mission.

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Improvement in Economic Freedom Versus Per Capita GDP Growth

Countries	Improvement in Economic Freedom	Compound Per Capita GDP Growth Rate (1992 to 2002)
Bosnia and Herzegovina*, Mauritania, Azerbaijan, Rwanda, Cape Verde, Nicaragua, Albania, Mozambique, Niger, Georgia, Armenia, Vietnam	1st Quartile	3.7 %
Haiti, Chad, Uganda, Kyrgyz Republic, India, Malawi, Ethiopia, Laos, Senegal, Bangladesh, Burkina Faso, Togo	2nd Quartile	1.5%
Republic of Congo, Tanzania, Moldova, Nepal, Madagascar, Yemen, Guyana, Mongolia, Djibouti, Pakistan, Gambia, Guinea, Cameroon	3rd Quartile	0.3%
Tajikistan, Bolivia, Honduras, Lesotho, Sri Lanka, Indonesia, Ghana, Kenya, Mali, Benin, Zambia, Nigeria	4th Quartile	0.6%

*GDP per capita for 1994-2002.

Source: Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at www.heritage.org/index.