Zooming Out: MCC Investments in Regional Integration

September 2024

Introduction

For much of MCC's history, compacts and threshold programs have focused on country-specific investments that capitalize on national or sub-national opportunities for growth and poverty reduction. While this strategy continues to dominate MCC's portfolio, "concurrent regional compacts" have gained steam since they were first authorized by Congress in 2018. (See textbox for additional context.) Regional compacts envision investments that specifically target regional integration by improving access to neighboring markets, exploiting economies of scale, and fostering cross-border collaborations. Regional integration can also pave the way to larger, more influential engagements with the broader global economy and facilitate region-wide cooperation in response to crises including natural disasters, public health, and conflicts.

MCC's regional compacts operate at different country aggregations and help sustain broader engagements with partner countries. In the most straightforward instance, a regional compact consists of bilateral but thematically unified compacts signed with two or three contiguous country partners. Cross-border roads to facilitate trade or a multi-country power transmission network are canonical examples. In certain cases, however, regional compacts may operate in just one country. A "single-country regional compact" still focuses on a country's integration with its neighbors and potentially gives rise to more expansive regional scopes and creative investments, e.g., fisheries management along shared coastal waters. Because a partner country may host a regional compact concurrently with a traditional one, it allows for a progressive and evolving engagement over a longer time horizon. In the same spirit, partner countries that have had two compacts with MCC are also eligible for a fresh regional compact.

On the origin of regions: MCC's evolving approach to regional compacts

In 2018, Congress amended the Millennium Challenge Act of 2003 to permit MCC to undertake concurrent compacts with a country partner so long as "one or both of the Compacts are or will be for purposes of regional economic integration, increased regional trade, or cross-border collaborations." Even though the addition of concurrency endowed MCC with the potential to achieve broader engagement horizons, the statute's regional qualification raised new challenges around operations, definitions, and priorities.

Most immediate was the longstanding legal requirement for MCC to sign a separate compact with each partner country, a process that acquires greater complexity, and correspondingly more time, in a joint multi-country effort.

The term "regional" also bore some interpretation, connoting either a group of border-sharing countries or non-contiguous countries within a geographic region. More broadly interpreted, "regional" could simply describe a single country's outward economic orientation. Reflecting these different conceptions, MCC's regional compacts to date, included programs that were jointly initiated with multiple country partners as well as those launched in single country settings.

Finally, regional compacts' *ex ante* prioritization of regional integration vis-à-vis other (possibly more binding) domestic constraints to economic growth bypasses MCC's standard practice of beginning with a constraints to growth analysis. In early instances, this was exacerbated by time pressures arising from coordinating compacts across multiple country partners and resulted in *ad hoc* selection of projects for investment. To preserve its distinctive approach to compact design, MCC has explored alternative analytic approaches in its most recent round of regional selects.

Regional integration across a variety of dimensions remains largely incomplete in low-income countries, especially in sub-Saharan Africa (Figure 1). According to the Africa Regional Integration Index (ARII), infrastructural and productive integration are particularly weak, though trade-related integration, the most visible indicator, is similarly poor.[1] In light of these conditions, and given its conceptual breadth, regional integration strategies offer multiple entry points for MCC along with other development partners, including USAID and the World Bank, to pursue their objectives of economic development and poverty reduction.[2]

Villages to cities? Or capitals to capitals?

MCC's attention to regional compacts in part owes to the importance of trade and market integration as a significant driver of economic growth. A deep and well-established literature has studied the impact of access to global markets—whether achieved through policy and institutional reforms or investments in physical infrastructure—on jobs, incomes, and structural change (Irwin, 2024; Alessandria et al., 2023; Atkin and Donaldson, 2022). While effects are heterogenous across settings, results generally point to beneficial outcomes. In the context of more limited regional settings, research suggests improved connectivity among neighboring countries can lower prices, facilitate the movement of goods, raise productivity, and ultimately grow economies (Porteous, 2019; Graf, 2024). Investments in regional public goods, including basic research, disease control, and natural resource management, can also present channels for growth (Kanbur, 2004).

That said, distortive market conditions and weak institutions can interact with trade and integration in varying ways, often resulting in smaller benefits or unexpected twists. For example, constraints to labor mobility, across space, sectors, and formality, can strongly shape the efficiency gains and distributional effects of greater integration (McCaig and Pavcnik, 2018; Pavcnik, 2017). Questions of worker skills and firm competitiveness similarly bear on the outcomes, raising familiar questions of winners and losers. Meanwhile, common trade liberalization measures, such as lowering import tariffs, may reduce government revenues, and without a commensurate expansion of the tax base, can deprive resources from other social investments.

As such, the timing and size of regional investments that achieve the highest payoffs can appear murky relative to other competing investments on a policy maker's menu, particularly in high-poverty settings. Countries at different income levels[3], market sizes, and sectoral compositions may be poised differently to pursue region-scale strategies, and correspondingly, investments to promote growth through regional

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[1] The Africa Regional Integration Index's term "productive integration" describes the extent to which intermediate goods are traded within a region as well as the complementarity of products exported from a region. "Trade integration" spans several indicators, including intra-regional trade shares, import tariff levels, and membership in the African Continental Free Trade Area (AfCFTA)

[2] USAID leads regional programs across Africa (East, West, Southern, Central, and Sahel) focused on economic growth, humanitarian assistance, environmental management, and political stability. The World Bank's regional integration activities center on analytic support and convening power, technical and advisory services, and finance for infrastructure investment. Its Regional Integration and Cooperation Assistance Strategy included efforts to coordinate regional responses to the recent COVID-19 pandemic.

[3] MCC current statutory authority limits its engagements to low-income and lower middle-income countries (LICs and LMICs).

integration.[4] In sub-Saharan Africa, for example, opportunities for inter-regional trade are likely limited by the similarity of export baskets. In short, behind the choice to connect villages to cities versus capitals to capitals must lie a credible model for inclusive growth that accounts for a variety of variables and constraints, both observed and otherwise.

Concurrent compacts, compounding risks

Since 2018, MCC has launched several regional compacts, all located in West Africa, that pursue goals of integration and coordination among neighbors. Among the earliest programs, the **Burkina Faso- Cote d'Ivoire-Ghana Regional Energy Interconnection** compact aimed to strengthen the West African Power Pool, a regional effort to more efficiently operate and expand power utility services across the Economic Community of West African States (ECOWAS). MCC planned to support the installation of transmission lines linking the neighboring countries, providing more reliable supply to Burkina Faso and aiding Cote d'Ivoire to become a net power exporter. Meanwhile, The **Benin-Niger Regional Transport** compacts envisioned a transport corridor between Benin's port in Cotonou and Niger's capital, Niamey.

Unfortunately, each of these planned regional compacts suffered setbacks leading MCC to suspend activities in three countries. In Ghana, conditions precedents under the bilateral compact regarding the country's power sector management went unfulfilled, while political instability (read: coups) in Burkina Faso and Niger forced a termination of those countries' eligibility for an MCC program. With the remaining scope of investments limited to Cote d'Ivoire and Benin, MCC faced the unexpected prospect of rethinking its project designs for two effectively single-country regional compacts. Apart from the thematic disruption, these events left MCC's funds unobligated, exposing them to rescission pressures and adding uncertainty to MCC's budget.

In light of such experiences and the political risks that often hang over partner countries, MCC has taken steps to reduce the uncertainties of regional compacts by simply selecting just one country to host a regional compact. The idea is to address one country's integration with the surrounding region without depending on bilateral agreements among neighbors, and in the process, simplify compact development and implementation while enabling MCC to disburse funds more predictably. Building on this reality, MCC has since been working to develop new **single-country regional compacts with Senegal and Cabo Verde**.

Other risks also arise. The challenge of ever-evolving political priorities hangs over the management of assets that span multiple countries, particularly for water resource management and power utilities. Without sturdy institutional agreements that can withstand political crosswinds, investments in transnational infrastructure can suffer from disuse, mismanagement, or even destruction.[5] Additional operational risks associated with coordinating bilaterally signed compacts across multiple actors, including staggered election cycles, country-specific macro-risks, and MCC's own operational constraints and deadlines, e.g. its five-year clock, can potentially delay or derail a carefully tailored arrangement to support regional integration.

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[4] Spiezia and Weiler (2007) present a taxonomy of regional growth drivers in a within-country context that could be modified to fit a multi-country region.

[5] In an evaluation of its own regional integration efforts, the World Bank pointed to additional risks including loss of fiscal resources, heightened volatility in factor flows, and unevenly distributed benefits among participants (World Bank, 2019).

Analyzing and Redefining Regions

Given their statutory focus on integration, regional compacts are currently not informed by MCC's broad cross-sectoral diagnostic for identifying constraints to economic growth. That said, understanding how different aspects of integration, e.g., cross-border roads, power trade, or a jointly managed natural resource, can support growth and poverty reduction remains critical. Currently, guidance on empirical tests to compare these alternatives, or more broadly assess the kinds of integration that best stimulate growth, is limited. As a result, MCC has relied on off-the-shelf proposals from counterparts, making it more difficult to do an accurate early assessment of which projects maximize impact on growth and poverty reduction.[6] Are the benefits of cheaper inter-regional transport greater than the efficiencies achieved from a scaled-up multi-national power utility? What are the distributional benefits of managing offshore fisheries versus an underground aquifer? A deeper understanding of integration's benefits, across its different forms, can help MCC better choose, design, and evaluate its investments.

More broadly, while the authorizing statute for regional compacts mentions cross-border relationships as a basis for investment, the notion of a region arguably spans more than a country's contiguous neighbors. A region's boundaries may well vary according to different criteria. Africa is home to several "regional economic communities," including ECOWAS which encompasses a diverse population of 400 million people. Continent-wide trade agreements, such as the African Continental Free Trade Area, push the boundaries of regions even further. Smaller regions may count on more narrowly shared geographies, histories, or languages. In the extreme case of Cabo Verde, an island nation, no bordering countries exist at all, and as the government itself argues, Europe is its most relevant region. To the extent that a regional compact's scope is flexibly defined, even if MCC's partner countries number just one or two, opportunities for creative investments in integration can multiply.

Regional compacts may even conceive of collective access to global markets. For example, a program could aid land-locked countries like Zambia or Malawi to more easily access the seaports of their coastal neighbors, Tanzania and Mozambique, and thereby reach more lucrative export markets in the Middle East and Asia. In this setting, the region's members are not trading partners so much as trade-facilitation partners. In a different way, regional integration might entail improving local IT capabilities via high-speed networks that ultimately connect to undersea cables.

Across these scenarios, deeper questions loom. What kind of trade, and more broadly integration, exerts the greatest poverty reduction effect? Trade with rich markets that are far away, or with lower-income partners nearby? Does regional integration pertain strictly to the movement of goods? Or is there room to consider labor's movement across borders? How do institutional and infrastructural integration interact, and is there an optimal sequencing of the two? How can MCC best wield the flexibilities of regional compacts while adhering closely to its main mission of poverty reduction through economic growth?

[6] MCC's preliminary analysis consists of two main phases: the constraints analysis (CA), which aims to diagnose the broad factors that most constrain growth, and the root cause analysis (RCA), which digs deeper into the technical and institutional drivers behind a particular constraint. Given the absence of a CA in regional compact development, RCAs play an outsized role in ensuring MCC's infrastructural investment addresses a well-diagnosed problem and is grounded in the policy and operational environment it inhabits.

Questions for the EAC

Tradeoffs between regional and traditional compacts

1. How does the EAC view MCC's *ex ante* prioritization of regional integration over other potential binding constraints to economic growth in a partner country? In general, how do the benefits of regional integration likely compare to locally or nationally oriented investments?

Prioritizing across different kinds of integration

2. What diagnostics can MCC undertake to prioritize among different regional integration investments? Is it enough to rescope its standard growth diagnostics and simply assess constraints to trade and connectivity?
3. When weighing different investments in regional integration, what on-the-ground conditions and factors should MCC explicitly account for? In general, given the settings MCC most commonly works in, are certain kinds of integration more impactful on growth and poverty?
4. Much of the literature on trade and integration focuses on access to global markets. How responsive is growth and poverty to regional integration versus more far-flung global partnerships? Is intra-region trade itself particularly valuable, or is the real benefit collective access to wealthier markets?

Going beyond trade

5. Should MCC's conception of regional integration include labor mobility or more broadly, migration? How important are labor movement frictions relative to other features of integration in explaining factor reallocations, and is MCC well-placed to address this?
6. Regional power pools and other supranational entities offer the prospect of greater scale efficiencies but at some cost to national sovereignty or simply national political control. How tenable are such arrangements and how great are the operational risks? Considering these risks, what benefits do region-scale investments in utilities promise for poverty reduction?

Single-country compacts

7. Notwithstanding their novelty and usefulness, what are the risks and downsides of single-country regional compacts? Are there credible projects that operate inside a country that nonetheless achieve an integration goal? How should MCC define a region for these countries?

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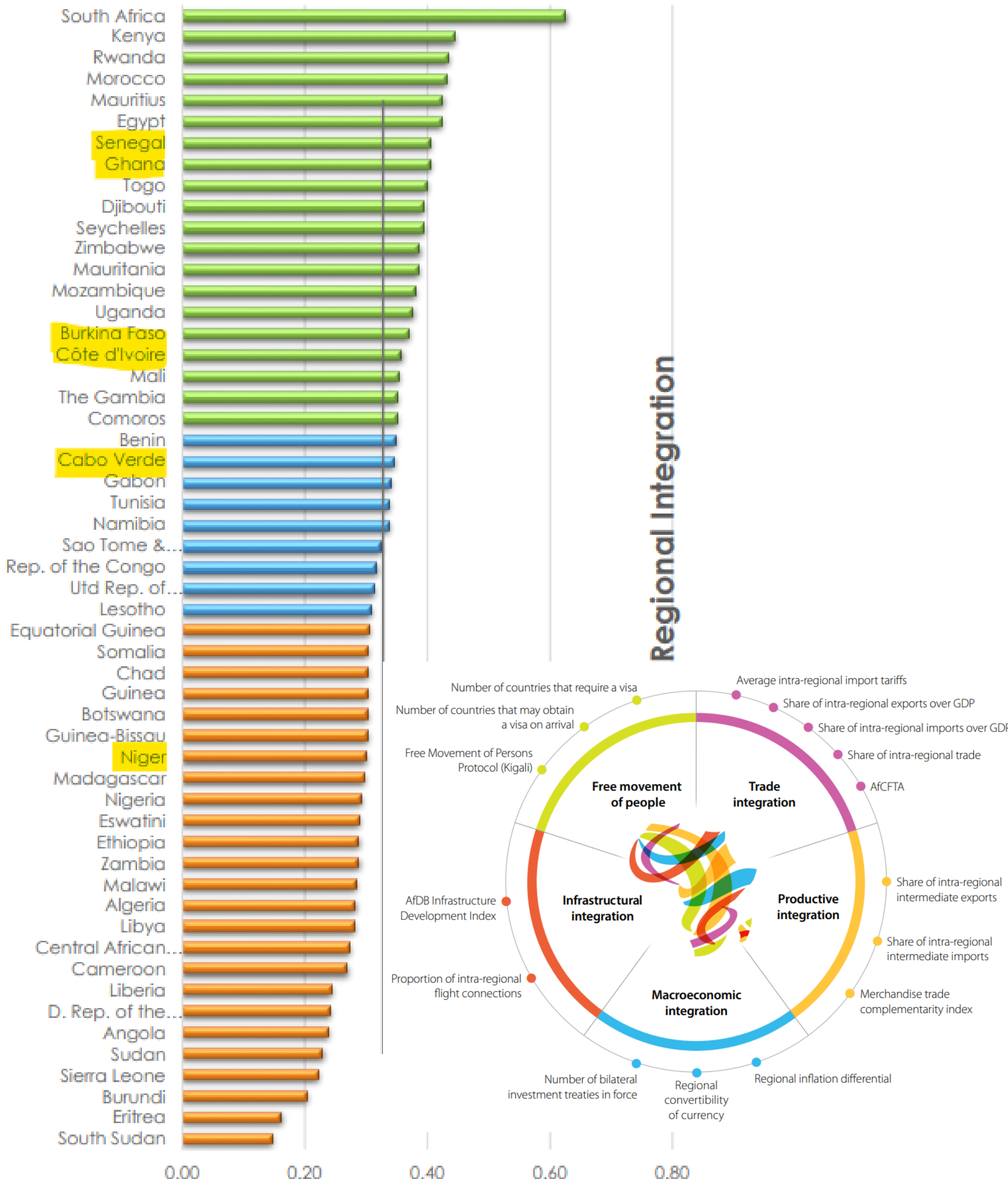

Figure 1 Africa Regional Integration Index: rankings, dimensions, and elements. Source: African Union, African Development Bank, and UN Economic Commission for Africa (link). Note: Highlighted countries correspond to a current or past MCC regional compact partner.