



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

In accordance with section 608(b)(1) of the Millennium Challenge Act of 2003 (the “Act”, 22 U.S.C. 7707(b)(1)), the Millennium Challenge Corporation (MCC) is submitting the enclosed report. This report identifies the criteria and methodology that the Millennium Challenge Corporation (MCC) intends to use to determine which of these candidate countries may be eligible to be considered for assistance under the Act in FY2011.

As required by the Act, MCC will publish the information contained in the enclosed report in the *Federal Register*. In addition, under section 608 (c)(1) of the Act, MCC will, for a thirty 30-day period following publication, accept and consider public comment for purposes of determining eligible countries under section 607 of the Act (22 U.S.C. 7706).

In accordance with Section 608 (c)(2) of the Act (22 U.S.C. 607(c)(2)), MCC staff are available to meet with you to discuss the extent to which candidate countries meet the criteria contained in this report. If you or your staff would like to arrange a meeting, please contact Ellona Fritschie (Senate affairs) or Erin Kolodjeski (House affairs) in the Department of Congressional and Public Affairs at (202) 521-3850. The enclosed report is being sent to Congress on September 30, 2010.

Sincerely,

T. Charles Cooper
Vice President
Congressional and Public Affairs

Enclosure:
As stated

Millennium Challenge Corporation

**Report on the Criteria
and Methodology
for Determining the
Eligibility of Candidate
Countries for Millennium
Challenge Account
Assistance for
Fiscal Year 2011**

September 2010



MILLENNIUM
CHALLENGE CORPORATION

Summary

This report to Congress is provided in accordance with section 608(b) of the Millennium Challenge Act of 2003, as amended, 22 U.S.C. §7707(b) (the “Act”).

The Act authorizes the provision of Millennium Challenge Account (MCA) assistance to countries that enter into a Millennium Challenge Compact with the United States to support policies and programs that advance the prospects of such countries achieving lasting economic growth and poverty reduction. The Act requires the Millennium Challenge Corporation (MCC) to take a number of steps in determining what countries will be selected as eligible for MCA compact assistance for fiscal year 2011 (FY11) based on the countries’ demonstrated commitment to just and democratic governance, economic freedom, and investing in their people, as well as MCC’s opportunity to reduce poverty and generate economic growth in the country. These steps include the submission of reports to the congressional committees specified in the Act and publication of notices in the *Federal Register* that identify:

- ★ The countries that are “candidate countries” for MCA assistance for FY11 based on their per capita income levels and their eligibility to receive assistance under U.S. law. This report also identifies countries that would be candidate countries but for specified legal prohibitions on assistance (section 608(a) of the Act; 22 U.S.C. §7707(a));
- ★ The criteria and methodology that MCC’s Board of Directors (Board) will use to measure and evaluate the policy performance of the candidate countries consistent with the requirements of section 607 of the Act (22 U.S.C. 7706) in order to determine “MCA eligible countries” from among the “candidate countries” (section 608(b) of the Act); and
- ★ The list of countries determined by the Board to be “MCA eligible countries” for FY11, with justification for eligibility determination and selection for compact negotiation, including with which of the MCA eligible countries the Board will seek to enter into MCA compacts (section 608(d) of the Act).

This report is the second of the three required reports listed above.

Criteria and Methodology for FY11

The Board will base its selection of eligible countries on several factors including:

- ★ The country’s overall performance in three broad policy categories—*Ruling Justly*, *Encouraging Economic Freedom*, and *Investing in People*;
- ★ MCC’s opportunity to reduce poverty and generate economic growth in a country; and

- ★ Availability of funds to MCC.

Performance in Policy Categories

Section 607 of the Act requires that the Board's determination of eligibility be based "to the maximum extent possible, upon objective and quantifiable indicators of a country's demonstrated commitment" to the criteria set out in the Act.

For FY11, there will be two groups of candidate countries – low income countries (LIC) and lower middle income countries (LMIC). As outlined in MCC's *Report on Countries that are Candidates for Millennium Challenge Account Eligibility for Fiscal Year 2011 and Countries that would be Candidates but for Legal Prohibitions* (August 2010), LIC candidates are those countries that have a per capita income equal to or less than \$1,905 and are not ineligible to receive United States economic assistance under part I of the Foreign Assistance Act of 1961 by reason of the application of any provision of the Foreign Assistance Act or any other provision of law. LMIC candidates are those countries that have a per capita income between \$1,906 and \$3,945 and are not ineligible to receive United States economic assistance under the same stipulations.

The Board uses seventeen indicators to assess the policy performance of individual countries (specific definitions of the indicators and their sources are set out in the attached Annex A). These indicators are grouped for purposes of the FY11 assessment methodology under the three policy categories listed below.

Ruling Justly	Encouraging Economic Freedom	Investing in People
Civil Liberties	Inflation	Public Expenditure on Health
Political Rights	Fiscal Policy	Public Expenditure on Primary Education
Voice and Accountability	Business Start-Up	Immunization Rates
Government Effectiveness	Trade Policy	Girls' Primary Education Completion
Rule of Law	Regulatory Quality	Natural Resource Management
Control of Corruption	Land Rights and Access	

In making its determination of eligibility with respect to a particular candidate country, the Board will consider whether a country performs above the median in relation to its income level peers (LIC or LMIC) on at least three of the indicators in each of the *Ruling Justly*, *Encouraging Economic Freedom*, and *Investing in People* categories, and above the median on the *Control of Corruption* indicator. One exception to this methodology is that the median is not used for the *Inflation* indicator. Instead, to pass the *Inflation* indicator a country's inflation rate must

be under a fixed ceiling of 15 percent. The Board may also take into consideration whether a country performs substantially below the median on any indicator (*i.e.*, below the 25th percentile) and has not taken appropriate measures to address this shortcoming.

Approach to Income Classification Transition

Each year a number of countries shift income groups, and some countries formerly classified as LICs suddenly face new, higher performance standards in the LMIC group. As a result, they typically perform relatively worse as an LMIC, even if they performed relatively well as an LIC, and maintained or improved performance over the previous year in absolute terms. To address the challenges associated with sudden changes in performance standards for these countries, MCC has adopted an approach to income category transition whereby the Board may consider the indicator performance of countries that transitioned from the LIC to the LMIC category both relative to their LMIC peers, as well as in comparison to the current fiscal year's LIC pool for a period of three years.

Supplemental Information

While the indicators are the predominant basis for determining which countries will be eligible for MCA assistance, it is consistent with the Act for the Board to exercise discretion when evaluating performance on the indicators and determining a final list of eligible countries. The Board may take into account other quantitative and qualitative information (supplemental information) to determine whether a country performed satisfactorily in relation to its peers in a given income category. Such supplemental information is important because there are elements of the eligibility criteria set out in the Act for which there is either limited quantitative information (*e.g.*, the rights of people with disabilities) or no well-developed performance indicator. Until such data and/or indicators are developed, the Board may rely on additional data and qualitative information to assess policy performance. For example, the State Department Human Rights Report contains qualitative information to make an assessment on a variety of criteria outlined by Congress, such as the rights of people with disabilities, the treatment of women and children, workers rights, and human rights.

Supplemental information is also important because it makes up for data gaps, lags, trends, or other weaknesses in particular indicators. For example, the median score (and passing threshold) for the *Girls' Primary Education Completion* indicator in the LMIC group has historically been very high. Recognizing that this may pose limitations on the indicator's ability to meaningfully differentiate policy performance, the Board may consider that a girls' primary education completion rate above 95 percent essentially represents full completion, regardless of where the median score for this indicator falls. As additional information in the area of corruption, the Board may consider how a country is evaluated by supplemental sources like Transparency International's Corruption Perceptions Index and the Global Integrity Report, among others, as well as on the defined indicator.

Consideration for Subsequent Compacts

Countries nearing the end of compact implementation may be considered for eligibility for a second compact. In determining eligibility for a second compact, the Board will consider, among other factors, the country's policy performance using the methodology and criteria described above and the country's track record of performance implementing its first compact. To assess implementation of a first compact, the Board will consider the nature of the country partnership with MCC, the degree to which the country has demonstrated a commitment and capacity to achieve program results, and the degree to which the country has implemented the compact in accordance with MCC's policies and standards.

Continuing Policy Performance

Partner countries that are developing or implementing a compact are expected to seek to maintain and improve policy performance. MCC recognizes that partner countries may not meet the indicator criteria from time to time due to a number of factors, such as changes in the peer-group median; transition into a new income category (e.g., from LIC to LMIC); numerical declines in score that are within the statistical margin of error; slight declines in policy performance; revisions or corrections of data; the introduction of new sub-data sources; or changes in the indicators used in measuring performance. None of these factors alone signifies a significant policy reversal or warrants suspension or termination of eligibility and/or assistance.

However, MCC may issue a warning, suspension, or termination of eligibility and/or assistance to countries that demonstrate a significant policy reversal. According to MCC's authorizing legislation, "[a]fter consultation with the Board, the Chief Executive Officer may suspend or terminate assistance in whole or in part for a country or entity ... if ... the country or entity has engaged in a pattern of actions inconsistent with the criteria used to determine the eligibility of the country or entity" Because of data lags, this pattern of actions need not be captured in the indicators for MCC to take action.

Consideration of Changes to the Criteria and Methodology

For FY11, there are no changes to the core criteria or methodology used in FY10.

In keeping with MCC's commitment to aid effectiveness through regular evaluation of its own practice, MCC is undertaking a comprehensive review of its country selection process. At the time the selection system was established, MCC's country scorecard represented the most effective way to use third-party data to compare policy performance as objectively as possible across the broad majority of low and lower middle income countries. After using this system for six years, MCC believes it is appropriate to undertake a review to ensure that the most effective indicator system is being used to evaluate and select countries for eligibility. While the review may find that

MCC should make no changes to the selection system, it may, alternatively, identify recommended adjustments. Any such adjustments could be implemented as part of the fiscal year 2012 selection process.

The selection review is in its early stages and planned to extend through mid-2011. The review will include consultations with a broad range of stakeholders and experts in the development community. As a first step, MCC encourages broad participation in the formal public comment period that follows the publication of this report and lasts until December 15.

Relationship to Statutory Criteria

Within each policy category, the Act sets out a number of specific selection criteria. As indicated above, a set of objective and quantifiable policy indicators is used in determining eligibility for MCA assistance and in measuring the relative performance by candidate countries against these criteria. Performance against each of these criteria is assessed by at least one of the seventeen objective indicators and some criteria are addressed by multiple indicators. The following list of the criteria set forth in the Act identifies in parentheses the corresponding indicators.

Section 607(b)(1): Just and democratic governance, including a demonstrated commitment to —

- (A) Promote political pluralism, equality and the rule of law (*Political Rights, Civil Liberties, Voice and Accountability, and Rule of Law*);
- (B) Respect human and civil rights, including the rights of people with disabilities (*Political Rights, Civil Liberties, and Voice and Accountability*);
- (C) Protect private property rights (*Civil Liberties, Regulatory Quality, Rule of Law, and Land Rights and Access*);
- (D) Encourage transparency and accountability of government (*Political Rights, Civil Liberties, Voice and Accountability, Control of Corruption, Rule of Law, and Government Effectiveness*); and
- (E) Combat corruption (*Political Rights, Civil Liberties, Rule of Law, and Control of Corruption*).

Section 607(b)(2): Economic freedom, including a demonstrated commitment to economic policies that —

- (A) Encourage citizens and firms to participate in global trade and international capital markets (*Fiscal Policy, Inflation, Trade Policy, and Regulatory Quality*);
- (B) Promote private sector growth (*Inflation, Business Start-Up, Fiscal Policy, Land Rights and Access, and Regulatory Quality*);

- (C) Strengthen market forces in the economy (*Fiscal Policy, Inflation, Trade Policy, Business Start-Up, Land Rights and Access, and Regulatory Quality*); and
- (D) Respect worker rights, including the right to form labor unions (*Civil Liberties and Voice and Accountability*).

Section 607(b)(3): Investments in the people of such country, particularly women and children, including programs that —

- (A) Promote broad-based primary education (*Girls' Primary Education Completion and Public Expenditure on Primary Education*);
- (B) Strengthen and build capacity to provide quality public health and reduce child mortality (*Immunization Rates, Public Expenditure on Health, and Natural Resource Management*); and
- (C) Promote the protection of biodiversity and the transparent and sustainable management and use of natural resources (*Natural Resource Management*).

Annex A: Indicator Definitions

The following 17 indicators will be used in measuring candidate countries' demonstrated commitment to the criteria set forth in section 607(b) of the Act. The indicators are intended to assess the degree to which the political and economic conditions in a country serve to promote broad-based sustainable economic growth and reduction of poverty, and thus provide a sound environment for the use of MCA funds. The indicators are not goals in themselves; rather they are proxy measures of policies that are linked to broad-based sustainable economic growth. The indicators were selected based on their (i) relationship to economic growth and poverty reduction; (ii) the number of countries they cover; (iii) transparency and availability; and (iv) relative soundness and objectivity. Where possible, the indicators are developed by independent sources.

Ruling Justly

1. *Civil Liberties*: Independent experts rate countries on: freedom of expression; association and organizational rights; rule of law and human rights; and personal autonomy and economic rights, among other things. Source: *Freedom House*
2. *Political Rights*: Independent experts rate countries on: the prevalence of free and fair elections of officials with real power; the ability of citizens to form political parties that may compete fairly in elections; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies and economic oligarchies; and the political rights of minority groups, among other things. Source: *Freedom House*
3. *Voice and Accountability*: An index of surveys and expert assessments that rate countries on: the ability of institutions to protect civil liberties; the extent to which citizens of a country are able to participate in the selection of governments; and the independence of the media, among other things. Source: *Worldwide Governance Indicators (World Bank/Brookings Institution)*
4. *Government Effectiveness*: An index of surveys and expert assessments that rate countries on: the quality of public service provision; civil servants' competency and independence from political pressures; and the government's ability to plan and implement sound policies, among other things. Source: *Worldwide Governance Indicators (World Bank/Brookings Institution)*
5. *Rule of Law*: An index of surveys and expert assessments that rate countries on: the extent to which the public has confidence in and abides by the rules of society; the incidence and impact of violent and nonviolent crime; the effectiveness, independence, and predictability of the judiciary; the protection of property rights; and the enforceability of contracts, among other things. Source: *Worldwide Governance Indicators (World Bank/Brookings Institution)*
6. *Control of Corruption*: An index of surveys and expert assessments that rate countries on: "grand corruption" in the political arena; the frequency of petty corruption; the effects of corruption on the business

environment; and the tendency of elites to engage in “state capture,” among other things. Source: *Worldwide Governance Indicators (World Bank/Brookings Institution)*

Encouraging Economic Freedom

1. *Inflation*: The most recent average annual change in consumer prices. Source: *The International Monetary Fund's World Economic Outlook Database*
2. *Fiscal Policy*: The overall budget balance divided by GDP, averaged over a three-year period. The data for this measure come primarily from IMF country reports or, where public IMF data are outdated or unavailable, are provided directly by the recipient government with input from U.S. missions in host countries. All data are cross-checked with the IMF's World Economic Outlook database to try to ensure consistency across countries and made publicly available. Source: *International Monetary Fund Country Reports, National Governments, and the International Monetary Fund's World Economic Outlook Database*
3. *Business Start-Up*: An index that rates countries on the time and cost of complying with all procedures officially required for an entrepreneur to start up and formally operate an industrial or commercial business. Source: *International Finance Corporation*
4. *Trade Policy*: A measure of a country's openness to international trade based on weighted average tariff rates and non-tariff barriers to trade. Source: *The Heritage Foundation*
5. *Regulatory Quality*: An index of surveys and expert assessments that rate countries on: the burden of regulations on business; price controls; the government's role in the economy; and foreign investment regulation, among other areas. Source: *Worldwide Governance Indicators (World Bank/Brookings Institution)*
6. *Land Rights and Access*: An index that rates countries on the extent to which the institutional, legal, and market framework provide secure land tenure and equitable access to land in rural areas and the time and cost of property registration in urban and peri-urban areas. Source: *The International Fund for Agricultural Development and the International Finance Corporation*

Investing in People

1. *Public Expenditure on Health*: Total expenditures on health by government at all levels divided by GDP. Source: *The World Health Organization*
2. *Immunization Rates*: The average of DPT₃ and measles immunization coverage rates for the most recent year available. Source: *The World Health Organization and the United Nations Children's Fund*
3. *Total Public Expenditure on Primary Education*: Total expenditures on primary education by government at all levels divided by GDP. Source: *The United Nations Educational, Scientific and Cultural Organization and National Governments*

4. *Girls' Primary Completion Rate*: The number of female students enrolled in the last grade of primary education minus repeaters divided by the population in the relevant age cohort (gross intake ratio in the last grade of primary). Source: *United Nations Educational, Scientific and Cultural Organization*
5. *Natural Resource Management*: An index made up of four indicators: eco-region protection, access to improved water, access to improved sanitation, and child (ages 1-4) mortality. Source: *The Center for International Earth Science Information Network and the Yale Center for Environmental Law and Policy*