



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

The Millennium Challenge Corporation (MCC) is submitting the enclosed report in accordance with section 608(b)(1) of the Millennium Challenge Act of 2003 (Pub. L. 108-199, Division D), as amended (the "Act"). On September 4, 2008, MCC transmitted to the appropriate congressional committees a report listing the countries that are candidates countries under the Act for fiscal year ("FY") 2009. The enclosed report contains a list of the criteria and methodology that MCC will use to determine the eligibility of candidate countries for compact assistance for FY 2009.

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

In accordance with section 608 (c)(2) of the Act, 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 Contact) or Ven Neralla (House Contact) in the Department of Congressional and Public Affairs at (202) 521-3850. The enclosed report is being sent to Congress on October 9, 2009.

Sincerely,

Matthew K. McLean
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 in
Fiscal Year 2009**

October 2008



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Summary

This report to Congress is provided in accordance with section 608(b) of the Millennium Challenge Act of 2003, 22 U.S.C.A. §§7701, 7707(b) (the Act).

The Act authorizes the provision of Millennium Challenge Account (MCA) assistance to countries that enter into compacts 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 the countries that, based on their demonstrated commitment to just and democratic governance, economic freedom and investing in their people, and the opportunity to reduce poverty and generate economic growth in the country, will be eligible for MCA assistance during fiscal year 2009 (FY09). These steps include the submission of reports to the congressional committees specified in the Act and the publication of notices in the *Federal Register* that identify:

1. The countries that are “candidate countries” for MCA assistance during FY09 based on their per-capita income levels and their eligibility to receive assistance under U.S. law, and countries that would be candidate countries but for specified legal prohibitions on assistance (section 608(a) of the Act);
2. The criteria and methodology that the Board of Directors of MCC (the Board) will use to measure and evaluate the relative policy performance of the candidate countries consistent with the requirements of section 607 of the Act in order to select “MCA eligible countries” from among the “candidate countries” (section 608(b) of the Act); and
3. The list of countries determined by the Board to be “MCA eligible countries” for FY09, with justification for eligibility determination and selection for compact negotiation, including which of the MCA eligible countries the Board will seek to enter into MCA compacts (section 608(d) of the Act).

This report sets out the criteria and methodology to be applied in determining eligibility for new partner countries for FY09 MCA assistance.

The Criteria and Methodology for FY09

MCC reviews all of its indicators and methodology annually to ensure that the best measures are being used and, from time to time, recommends changes or refinements if MCC identifies better methodologies, better indicators, or improved sources of data. MCC takes into account public comments received on the previous year’s criteria and methodology and consults with a broad range of experts in the development community and within the U.S. Government.

MCC recommends no changes to the selection criteria and methodology for this fiscal year.

Potential Future Changes

Since FY07, MCC has pursued research and consultation to explore the possibility of adopting a new education indicator in the Investing in People category. However, MCC was unable to identify an indicator that would significantly strengthen the selection criteria in FY09. MCC will continue to explore potential measures. Over the last fifteen years, much attention has been focused on enrolling and keeping more children in school, but not necessarily on enhancing the quality of education. With the support of the World Bank, USAID, UNESCO, the Basic Education Coalition, and others, efforts are currently underway to develop cross-country measures of learning outcomes, educational quality, and governments' commitment to improving educational quality. However, these efforts are still under development and there are currently no education quality indicators that are viable for MCC purposes at this time. In assessing new indicators, MCC favors those that: (1) are developed by an independent third party; (2) utilize objective and high quality data that rely upon an analytically rigorous methodology; (3) are publicly available; (4) have broad country coverage; (5) are comparable across countries; (6) have a clear theoretical or empirical link to economic growth and poverty reduction; (7) are policy linked (i.e., measure factors that governments can influence within a two to three year horizon); and (8) have broad consistency in results from year to year.

Many of MCC's candidate countries in the lower middle income category have realized substantial success in achieving high levels of performance on select Investing in People indicators. MCC will explore options for alternative measures of an Investing in People policy framework that do a better job of distinguishing among high performers to incorporate in future fiscal years for the lower middle income countries.

Several of MCC's early compacts are due to conclude within the next two years. MCC will review whether the selection criteria and methodology should be modified when applied to selecting a country as eligible for a second compact.

Criteria and Methodology

The Board will select eligible countries based on the following, among other factors: (1) their overall performance in relation to their income-level peers in three broad policy categories—*Ruling Justly*, *Encouraging Economic Freedom*, and *Investing in People*; (2) the opportunity to reduce poverty and generate economic growth. 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 FY09, there will be two groups of candidate countries—low income countries and lower middle income countries. Low income candidate countries refer to those countries that have a per capita income equal to or less than \$1,785 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. Lower middle income candidate countries are those that have a per capita income between \$1,786 and \$3,705 and are not ineligible to receive United States economic assistance.

The Board will make use of seventeen indicators to assess policy performance of individual countries (specific definitions of the indicators and their sources are set out in annex A). These indicators are grouped for purposes of the FY09 assessment methodology under the three policy categories listed below.

Ruling Justly	Encouraging Economic Freedom	Investing in People
1. Civil Liberties	1. Inflation	1. Public Expenditure on Health
2. Political Rights	2. Fiscal Policy	2. Public Expenditure on Primary Education
3. Voice and Accountability	3. Business Start-Up	3. Immunization Rates (DPT ₃ and Measles)
4. Government Effectiveness	4. Trade Policy	4. Girls' Primary Education Completion
5. Rule of Law	5. Regulatory Quality	5. Natural Resource Management
6. Control of Corruption	6. 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 peers on at least half of the indicators in the Ruling Justly and Economic Freedom categories, above the median on at least three of the five indicators in the Investing in People category, 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 needs to be under a fixed ceiling of 15 percent. The Board will also take into consideration whether a country performs substantially below the median on any indicator (i.e. in the bottom 25th percentile) and has not taken appropriate measures to address this shortcoming. The indicator methodology will be the predominant basis for determining which countries will be eligible for MCA assistance. In addition, the Board may exercise discretion in evaluating performance on the indicators and determining a final list of eligible countries.

Where necessary, the Board may also 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 category. There are elements of the criteria set out in the Act for which there is either limited quantitative information (e.g., 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. The Board may also consider whether any adjustments should be made for data gaps, lags, trends, or other weaknesses in particular indicators. 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. Similarly, as additional information in the area of corruption, the Board may consider how a country scores on Transparency International's Corruption Perceptions Index and the Global Integrity Index, as well as on the defined indicator.

Compact eligible partners are expected to seek to maintain and improve policy performance. MCC recognizes that partner countries may not meet the formal eligibility criteria from time to time due to a number of factors, such as changes in the peer-group median; graduation into a new income category (e.g. from low income to lower middle income); numerical declines that are within the 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 to measure performance. None of these factors alone warrants suspension or termination of eligibility and/or assistance. Countries that demonstrate a significant policy reversal can face a warning, suspension, or termination of eligibility and/or assistance. 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 . . ." Given data lags, this pattern of behavior need not be captured in the indicators for MCC to take action. [See MCC's Policy on Suspension and Termination]

As provided in the Act, following the determination of eligible countries, the Chief Executive Officer's Report to Congress will set out the list of eligible countries, identify with which of those countries MCC will seek to enter into compact negotiations, and include a justification for such eligibility determinations and selections for compact negotiation.

Relationship to Legislative 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 to establish eligibility for MCA assistance and measure the relative performance by candidate countries against these criteria. The Board's approach to determining eligibility ensures that performance against each of these criteria is assessed by at least one of the seventeen objective indicators. Most are addressed by multiple indicators. The specific indicators used to measure each of the criteria set out in the Act are listed below.

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

(A) *promote political pluralism, equality and the rule of law;*

Indicators—Political Rights, Civil Liberties, Voice and Accountability, and Rule of Law

(B) *respect human and civil rights, including the rights of people with disabilities;*

Indicators—Political Rights, Civil Liberties, and Voice and Accountability

(C) *protect private property rights;*

Indicators—Civil Liberties, Regulatory Quality, Rule of Law, and Land Rights and Access

(D) *encourage transparency and accountability of government; and*

Indicators—Political Rights, Civil Liberties, Voice and Accountability, Control of Corruption, Rule of Law, and Government Effectiveness

(E) *combat corruption;*

Indicators—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;*

Indicators—Fiscal Policy, Inflation, Trade Policy, Business Start-Up, and Regulatory Quality

(B) *promote private sector growth;*

Indicators—Inflation, Business Start-Up, Fiscal Policy, Land Rights and Access, Natural Resource Management, and Regulatory Quality

(C) *strengthen market forces in the economy; and*

Indicators—Fiscal Policy, Inflation, Trade Policy, Business Start-Up, Land Rights and Access, and Regulatory Quality

(D) *respect worker rights, including the right to form labor unions;*

Indicators—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;*

Indicators—Girls' Primary Education Completion and Public Expenditure of Primary Education

(B) *strengthen and build capacity to provide quality public health and reduce child mortality; and*

Indicators—Immunization Rates, Public Expenditure on Health, and Natural Resource Management

(C) *promote the protection of biodiversity and the transparent and sustainable management and use of natural resources.*

Indicators—Natural Resource Management

Where necessary the Board will also draw on supplemental data and qualitative information, including the State Department's Human Rights Report, Transparency International's Corruption Perceptions Index, and the Global Integrity Index.

Annex A to Report: Indicator Definitions

The following 17 indicators will be used to measure candidate countries' demonstrated commitment to the criteria found 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 measure policies that are linked to broad-based sustainable economic growth. The indicators were selected based on their relationship to economic growth and poverty reduction, the number of countries they cover, their transparency and availability, and their relative soundness and objectivity. Where possible, the indicators are developed by independent sources.

Ruling Justly

Civil Liberties: A panel of independent experts rates countries on: freedom of expression; association and organizational rights; rule of law and human rights; and personal autonomy and economic rights. Source: *Freedom House*

Political Rights: A panel of independent experts rates 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. Source: *Freedom House*

Voice and Accountability: An index of surveys that rates 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. Source: *World Bank Institute*

Government Effectiveness: An index of surveys that rates 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. Source: *World Bank Institute*

Rule of Law: An index of surveys that rates countries on: the extent to which the public has confidence in and abides by the rules of society; the incidence of violent and nonviolent crime; the effectiveness, independence, and predictability of the judiciary; and the enforceability of contracts. Source: *World Bank Institute*

Control of Corruption: An index of surveys that rates countries on: the frequency of “additional payments to get things done;” the effects of corruption on the business environment; “grand corruption” in the political arena; and the tendency of elites to engage in “state capture.” Source: *World Bank Institute*

Encouraging Economic Freedom

Inflation: The most recent 12-month change in consumer prices as reported in the IMF’s International Financial Statistics or in another public forum by the relevant national monetary authorities. Source: *The International Monetary Fund’s World Economic Outlook (WEO) database*

Fiscal Policy: The overall budget deficit divided by GDP, averaged over a three-year period. The data for this measure relies primarily on IMF country reports with input from U.S. missions in host countries, or is provided directly by the recipient government where public IMF data is outdated or unavailable. All data is 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 (WEO) database*

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*

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*

Regulatory Quality: An index of surveys that rates countries on: the burden of regulations on business; price controls; the government’s role in the economy; foreign investment regulation; and many other areas. Source: *World Bank Institute*

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 (IFAD) and the International Finance Corporation*

Investing in People

Public Expenditure on Health: Total expenditures on health by government at all levels divided by GDP. Source: *The World Health Organization (WHO)*

Immunization Rates: The average of DPT₃ and measles immunization rates for the most recent year available.

Source: *The World Health Organization (WHO)*

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 (UNESCO) and National Governments*

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. Source: *United Nations Educational, Scientific and Cultural Organization (UNESCO)*

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 (CIESIN) and the Yale Center for Environmental Law and Policy (YCLEP)*