

Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in FY 2005

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 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, will be eligible for MCA assistance during Fiscal Year 2005. 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 Fiscal Year 2005 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 legal prohibitions on assistance (Section 608(a) of the Act);
2. The criteria and methodology that the Board of Directors of the Millennium Challenge Corporation (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 “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 “eligible countries” for Fiscal Year 2005, including which of the 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 FY 2005 MCA assistance.

Changes to the Criteria and Methodology for FY 2005

MCC has received constructive input on the indicators since the announcement of FY 2004’s selection criteria and methodology. That input has been taken into account in creating the criteria and methodology for the selection of eligible countries for FY05. Since the selection process for FY05 falls soon after the FY04 selection process, MCC will not make far-reaching changes this year, as continuity is a vital concept to the selection methodology. In addition, more time is necessary to fully evaluate some potential changes, including the use of additional or different policy indicators.

This section describes two changes in the policy indicators for the FY05 selection process. This section also outlines some potential changes to the indicators that will be explored for the FY06 process, in order to solicit comments from the public and to provide countries an opportunity to evaluate their performance in these areas prior to the possible implementation of more substantial changes.

We hope that by highlighting our intention to look for better and more comprehensive indicators we will stimulate interest in improving the available data. In assessing new indicators, we will favor those that: 1) are developed by an independent third party, 2) utilize objective and high-quality data, 3) are analytically rigorous and publicly available, 4) have broad country-coverage and are comparable across countries, 5) have a clear theoretical or empirical link to economic growth and poverty reduction, 6) are policy-linked, i.e. measure factors that governments can influence within a two to three year horizon, and 7) have broad consistency in results from year to year.

A summary of the changes (and potential future changes) to the selection criteria and methodology follows:

Economic Freedom:

- Inflation: A new inflation rate of 15 percent will be used in FY05 (down from the 20 percent rate used in FY04), making it slightly more difficult to pass and a more meaningful test of a country's economic policies. MCC intends to consider a further reduction to 10 percent for FY06.
- Management of Natural Resources: As indicated in the FY04 report to Congress, MCC has been working with experts both inside and outside of government to explore possible better measures in this area. MCC has not yet identified a source of reliable, consistent data for assessing the quality of a country's policies regarding the management of natural resources. In order to identify an existing natural resources management indicator or to stimulate development of a new indicator, MCC intends to establish a working group, chaired by MCC Board Member Christine Todd Whitman, to work with outside groups and experts to establish criteria, and invite proposals, for such an indicator. Pending the results of this work, the Board will rely on the assessments described in the "Criteria and Methodology" section below for the FY05 selection process.
- Trade Policy: The Trade Policy indicator is viewed by MCC as valuable and no changes will be made for the FY05 selection process. MCC intends, however, to conduct a thorough review over the next year to explore whether a measure of trade barriers more closely linked to growth is available.

- Entrepreneurial Environment: The Days to Start a Business indicator is viewed by MCC as a valuable indicator of barriers to entrepreneurship. In the future, MCC would like to move towards a more comprehensive measure of a country’s policies with respect to encouraging entrepreneurship and private-sector ownership. As such, in addition to continuing to use the Days to Start a Business indicator, in the coming year MCC will be investigating the use of related indicators, such as costs of starting businesses, time and costs of enforcing contracts, time and costs of land registration, protection of property rights, and the private sector’s share of the economy.

Investing in People:

MCC has evaluated the indicators in the Investing in People category and will substitute one indicator for FY05.

- Girls’ Primary Completion Rates: In FY05, we have substituted Girl’s Primary Completion Rates for Primary Completion Rates. We believe that using completion rate data disaggregated by gender both continues MCC’s focus on the importance of countries investing in the education of their people while better highlighting the importance of the well-being of women and girls as contributors to a country’s economic growth and poverty reduction.

MCC will continue to explore additional ways to measure investments in people, particularly with respect to women and children, and anticipates additional changes in FY06. MCC has, in conjunction with outside experts, researched possible indicators measuring investments in women’s health, children’s health, girls’ education, and public health. We have identified several possible indicators, including Skilled Attendants at Birth (a proxy for maternal mortality which measures births attended by medically-trained midwives, nurses or doctors), which will be considered more closely for potential use in FY06.

Criteria and Methodology

The Board will select eligible countries based on their overall performance in relation to their peers in three broad policy categories: Ruling Justly, Encouraging Economic Freedom, and Investing in People. 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 FY 2005, candidate countries are those countries that have a per capita income equal to or less than \$1465, and are not ineligible to receive United States economic assistance.

The Board will make use of sixteen 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 assessment methodology under the three policy categories as follows:

Ruling Justly:	Encouraging Economic Freedom:	Investing in People:
1. Civil Liberties 2. Political Rights 3. Voice and Accountability 4. Government Effectiveness 5. Rule of Law 6. Control of Corruption	1. Country Credit Rating 2. 1-year Consumer Price Inflation 3. Fiscal Policy 4. Trade Policy 5. Regulatory Quality 6. Days to Start a Business	1. Public Expenditures on Health as Percent of GDP 2. Immunization Rates: DPT3 and Measles 3. Public Primary Education Spending as Percent of GDP 4. Girls Primary Education Completion Rate

In making its determination of eligibility with respect to a particular candidate country, the Board will consider whether such country performs above the median in relation to its peers on at least half of the indicators in each of the three policy categories and above the median on the corruption indicator. One exception to this methodology is that the median is not used for the inflation indicator. Instead, to pass the indicator, a country’s inflation rate needs to be under a fixed ceiling of 15%. The indicators 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 and translating the indicators into a final list of eligible countries. In this respect, the Board may also consider whether any adjustments should be made for data gaps, lags, trends, or other weaknesses in particular indicators. Likewise, the Board may deem a country ineligible if it performs substantially below average on any indicator and has not taken appropriate measures to address this shortcoming.

Where necessary, the Board may also take into account other data and quantitative information as well as qualitative information to determine whether a country performed satisfactorily in relation to its peers in a given category. As provided in the Act, the CEO’s report to Congress setting out the list of eligible countries and which of those countries the MCC will seek to enter into Compact negotiations will include a justification for such eligibility determinations and selections for Compact negotiation.

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 (e.g., sustainable management of natural resources). Until such data and/or indicators are developed, in assessing performance in these areas the Board may rely on supplemental data and qualitative information. 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, worker rights, and human rights. Similarly, as additional information in the area of corruption, the Board may also consider how the country scores on Transparency International’s Corruption Perceptions Index.

The Board’s assessment of a country’s commitment to economic policies that promote the sustainable management of natural resources may make use of quantitative and qualitative information such as access to sanitation, deforestation, conservation of land and marine resources, land tenure institutions, and protection of threatened and endangered species. The MCC will continue to consult with experts and work to refine this approach over time, including by creating a working group that will establish and make public criteria for the indicator and continue to explore existing data with the objective of finding a suitable indicator.

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 being 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 sixteen objective indicators. Most are addressed by multiple indicators. The specific indicators used to measure each of the criteria set out in the Act are as follows:

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 and Civil Liberties.

(C) protect private property rights;

Indicators – Civil Liberties, Regulatory Quality and Rule of Law.

(D) encourage transparency and accountability of government; and

Indicators – Political Rights, Civil Liberties, Voice and Accountability, and Government Effectiveness.

(E) combat corruption;

Indicators – Civil Liberties and Control of Corruption.

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

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 – Country Credit Rating, Fiscal Policy, Inflation, Trade Policy, and Regulatory Quality.

(B) promote private sector growth and the sustainable management of natural resources;

Indicators – Inflation, Days to Start a Business, Fiscal Policy, and Regulatory Quality.

(C) strengthen market forces in the economy; and

Indicators – Fiscal Policy, Inflation, and Regulatory Quality.

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

Indicators – Civil Liberties.

Where necessary the Board will also draw on supplemental data and qualitative information including: the State Department’s Human Rights Report, access to sanitation, deforestation, conservation of land and marine resources, land tenure institutions, and protection of threatened and endangered species.

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

(A) promote broad-based primary education; and

Indicators – Girls’ Primary Education Completion Rate and Public Spending on Primary Education.

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

Indicators – Immunization and Public Spending on Health.

Annex A: Indicator Definitions

The following 16 indicators will be used to measure candidate countries' adherence 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 thus provide a sound environment for the use of MCA funds. The indicators are not goals in themselves; rather, they measure policies that are necessary conditions for a country to achieve broad-based sustainable economic growth. The indicators were selected based on their relationship to growth and poverty reduction, the number of countries they cover, their transparency and availability, and their relative soundness and objectivity. Where possible, the indicators rely on indices of performance developed by independent sources.

Ruling Justly:

- 1) *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*.
- 2) *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*.
- 3) *Voice and Accountability*: An index of surveys that rates countries on: 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*.
- 4) *Government Effectiveness*: An index of surveys that rates countries on: the quality of public service provision, civil services' competency and independence from political pressures, and the government's ability to plan and implement sound policies. Source: *World Bank Institute*.
- 5) *Rule of Law*: An index of surveys that rates countries on: the extent to which the public has confidence in and abides by rules of society; incidence of violent and non-violent crime; effectiveness and predictability of the judiciary; and the enforceability of contracts. Source: *World Bank Institute*.
- 6) *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:

- 1) *Country Credit Rating*: A semi-annual survey of bankers' and fund managers' perceptions of a country's risk of default. Source: *Institutional Investor Magazine*.
- 2) *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: *Multiple*.
- 3) *Fiscal Policy*: The overall budget deficit divided by GDP, averaged over a three-year period. The data for this measure is being provided directly by the recipient government and will be cross checked with other sources and made publicly available to try to ensure consistency across countries. Source: *National Governments and IMF WEO*.
- 4) *Days to Start a Business*: The Private Sector Advisory Service of the World Bank Group works with local lawyers and other professionals to examine specific regulations that impact business investment. One of their studies measures how many days it takes to open a new business. Source: *World Bank*.
- 5) *Trade Policy*: A measure of a country's openness to international trade based on average tariff rates and non-tariff barriers to trade. Source: *The Heritage Foundation's Index of Economic Freedom*.
- 6) *Regulatory Quality Rating*: 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*.

Investing in People:

- 1) *Public Expenditure on Health*: Total expenditures by government at all levels on health divided by GDP. Source: *National Governments*.
- 2) *Immunization*: The average of DPT3 and measles immunization rates for the most recent year available. Source: *The World Health Organization WHO*.
- 3) *Total Public Expenditure on Primary Education*: Total expenditures by government at all levels on primary education divided by GDP. Source: *National Governments*.
- 4) *Girls' Primary Completion Rate*: The number of female students completing primary education divided by the population in the relevant age cohort. Source: *World Bank and UNESCO*.