Report to Congress: MCC's Approach to Confronting Corruption

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Corruption fundamentally undermines economic growth, which is why the Millennium Challenge Corporation (MCC) directly addresses corruption when choosing partner countries and when developing and implementing programs. Corruption is challenging and multifaceted, and there is no single, simple action to deal appropriately and practically with all aspects of corruption. This report to Congress outlines MCC's overall three part approach for contending with corruption:

Country eligibility decisions—MCC uses its *Control of Corruption* indicator as a key measurement for eligibility;

Program implementation—MCC establishes a range of controls to prevent, detect, and mitigate against fraud and corruption during the course of program implementation; and

Continued monitoring—MCC regularly monitors corruption issues as a matter affecting country eligibility during the course of program implementation.

Considering Corruption when Making Country Eligibility Decisions

MCC's mandate is to work with relatively well-governed, poor countries. In order to assess countries that are relatively well-governed, MCC creates annual scorecards that use objective and quantifiable policy indicators in three broad policy categories: *Ruling Justly*, *Investing in People*, and *Encouraging Economic Freedom*. These policy indicators are developed by independent third party institutions, rely almost exclusively on objective and publicly available data, and have an analytically rigorous methodology. The *Control of Corruption* indicator is a "hard hurdle" to MCC eligibility. Countries must be in the top half of their income group on the corruption indicator to pass the scorecard, which places an assessment of anti-corruption efforts at the center of MCC's eligibility decision making process.

The inclusion of the *Control of Corruption* indicator as a hard hurdle is tied directly to MCC's mission to pursue economic growth and poverty reduction. Economics literature shows the importance of controlling corruption for economic growth and poverty reduction. Corruption hinders economic growth by increasing costs, lowering productivity, discouraging investment, and reducing confidence in public institutions. It can limit the development of small- and medium-sized enterprises, weaken systems of public financial management, and undermine investments in health and education.[1] Corruption also can increase poverty by slowing economic growth, skewing government expenditure in favor of the rich and well-connected, and concentrating public investment in unproductive projects. Corruption can result in public officials promoting a more regressive tax system, siphoning funds away from essential public services, adding a higher level of risk to the investment decisions of low-income individuals, and reinforcing patterns of unequal asset ownership, thereby limiting the ability of the poor to borrow and increase their income.[2]

To assess country performance on controlling corruption, MCC uses the Worldwide Governance Indicators'[3] *Control of Corruption* indicator on its scorecard. This indicator, produced annually by Brookings and the World Bank, measures the extent to which public power is exercised for private gain (including both petty and grand forms of corruption), as well as capture of the state by elites and private

interests. It also measures the strength and effectiveness of a country's policy and institutional framework to prevent and combat corruption.[4]

MCC also uses supplementary information to assess levels, trends, and instances of corruption, including quantitative and qualitative data and reports from third party experts; surveys on corruption; interagency information and reporting; and other flows of reliable information from nongovernmental organizations and technical experts at other donor agencies. An illustrative list of the types of supplementary data and reports MCC uses when assessing countries for eligibility and monitoring their performance over time can be found in Section III of this report.

MCC uses its threshold program as a tool to improve anti-corruption policies and practices.

The objective of MCC's Threshold Program is to assist a country in becoming compact eligible by supporting targeted policy and institutional reforms that are often related to control of corruption. A good example is Tanzania, which was selected as eligible for MCC threshold program assistance in fiscal year 2004. Tanzania's threshold program focused on reducing public corruption by strengthening nongovernmental monitoring capacity, curbing corruption on public procurement, establishing a financial intelligence unit, and strengthening the rule of law. As a result of threshold program support, the Tanzania Public Procurement Regulatory Authority conducted 39 audits of procuring entities, one of which uncovered irregularities in the procurement of electrical generators by the national electricity purveyor. This report was made public and the subsequent scandal attracted national attention and led to the resignation of several senior government officials, including the then-Prime Minster.

MCC Fraud and Corruption Controls

MCC safeguards against corruption in compact programs through multiple channels, including fiscal controls, procurement requirements, training for local Millennium Challenge Account (MCA) entities (the country unit implementing the MCC program), and referral of fraud and corruption allegations to the USAID Office of the Inspector General (OIG). MCC ensures that procurements are open, fair, and competitive through its Program Procurement Guidelines, expert review of procurement documents, and oversight of the procurement process, including review of selection methods, assessment of bidding documents, and bid evaluations.

On a quarterly basis, MCC approves fiscal accountability plans and reviews disbursement reports and requests to support effective financial management. Where MCC assesses local country systems to be insufficiently qualified, open, and transparent, MCAs use external procurement agents and fiscal agents who are hired through an international procurement process. All MCAs are required to hire outside auditors, whose reports are reviewed by both MCC staff and USAID OIG. The permanent presence of MCC staff (expatriate and local) in resident country missions provides on-the-ground support to and oversight of compact activities procured and implemented by the MCAs. In addition, MCC technical staff, MCC-hired independent engineers, USAID OIG, and the U.S. Government Accountability Office, all provide oversight on either a regular or an as-needed basis.

In 2009, MCC approved its *Policy on Preventing, Detecting, and Remediating Corruption and Fraud in MCC Operations* (Anti-Fraud and Corruption Policy). This policy includes actions that MCC has taken to enhance its capacity to prevent, detect, and remediate instances of fraud and corruption, including compact-specific fraud and corruption risk assessments. These assessments are developed to identify specific risks of fraud and corruption for each compact based on the unique projects, institutional, and country contexts. MCAs design action plans for controlling corruption, based on the risk assessments, which are approved and monitored by MCC. The Anti-Fraud and Corruption Policy also provides guidance to MCC and MCA staff on methods and strategies to prevent fraud and corruption. As part of the policy, MCC has clear and responsive mechanisms to respond to allegations of fraud or corruption in compacts. Administrative interventions or sanctions may occur if cases of fraud or corruption are detected.

As of February 2012, training on awareness and prevention of fraud and corruption has been provided in twelve countries. Training is provided by a contractor and overseen by a senior anti-fraud and corruption advisor with relevant experience in multiple U.S. Government agencies. As a result of this training, five anti-fraud and corruption action plans have been completed by local MCAs, approved by MCC and the relevant MCA Boards of Directors, and posted on MCA websites. Additional action plans are being developed and reviewed.

MCC has instituted an internal training program for all MCC staff involved in compact development or implementation. Training is delivered by a senior anti-fraud corruption advisor and an assistant general counsel, and covers the Anti-Fraud and Corruption Policy; the process of developing compact-specific fraud and corruption risk assessments; and the roles and responsibilities of MCC staff members in reporting potential cases of fraud and corruption. Training also includes several case studies that tests understanding of the issues and generates discussion.

In 2009, MCC established a fraud and corruption allegation intake team (Intake Team) to address allegations of fraud and corruption submitted to MCC. Allegations can be submitted confidentially through MCC's website; by e-mail to members of the Intake Team; or directly to the USAID Office of Inspector General. The Intake Team is chaired by MCC's senior investment and risk officer, who reports directly to MCC's chief executive officer, and includes an assistant general counsel and a representative from MCC's department of administration and finance. MCC's senior anti-fraud and corruption advisor also participates in meetings on a regular basis.

Allegations of fraud and corruption are reviewed and confidentially monitored by Intake Team members, who may confer with relevant MCC staff members in order to determine the specific nature of an allegation. The OIG is notified of all allegations, including those that are most likely to be flawed procurements. The Intake Team coordinates closely with USAID OIG on appropriate follow-up and meets regularly with OIG to discuss open allegations and to agree on when and under what circumstance allegations should be "closed." In serious cases, OIG may determine that it wants to undertake an investigation of the allegation and may request that MCC take no action (to include not informing the relevant MCA about the allegation) pending an OIG investigation. However, MCC will take administrative action, such as canceling a procurement when time is of the essence and when MCC must exercise its fiduciary responsibility (*e.g.,* minimize exposure of MCC funds to potential diversion or to prevent awarding a contract under questionable circumstances).

As of early February 2012, MCC had received about 80 allegations of fraud and corruption; approximately half of those pertained to procurement issues and a majority did not involve fraud and corruption.

However, several MCA staff members have been terminated and at least one person has been arrested in connection with information collected by OIG and/or MCC.

Monitoring Corruption with Partner Countries

MCC assesses corruption when determining country eligibility, and then continues to regularly monitor corruption within partner countries, as well as respond to stakeholders' specific corruption concerns. MCC monitors policy performance for all partner countries on an ongoing basis, and on an annual basis provides an update on policy performance for all partner countries to MCC's Board of Directors (Board). Specific events (high profile cases of corruption, a sudden change in policies or practices related to corruption, or sudden shifts in indicator scores) may trigger more intensive investigations and result in additional updates to interagencies and the Board.

When assessing levels, trends, and instances of corruption, MCC uses quantitative and qualitative data and reports from third party experts; surveys on corruption (population and firm surveys); interagency information and reporting; and other flows of reliable information (including nongovernmental organizations and technical experts at other donor agencies).

MCC uses data from government assessments, commercial business information providers, and non-governmental organizations to assess corruption issues, including: (i) the existence and utilization of anti-corruption laws and institutions; (ii) levels of bureaucratic regulations that create opportunities for corruption; (iii) the presence of active auditing and investigative bodies; (iv) prosecution of corrupt officials; (v) legal protection of whistleblowers; (vi) active anti-corruption civil society groups; and (vii) the business costs of corruption. Data and reports utilized by MCC come from:

★ African Development Bank Country Policy and Institutional Assessments

★ Asian Development Bank Country Policy and Institutional Assessments

★ Bertelsmann Transformation Index

★ Freedom House Countries at the Crossroads

★ Global Insight Global Risk Service

★ European Bank for Reconstruction and Development Transition Report

★ Economist Intelligence Unit Risk-wire & Democracy Index

★ Freedom House

★ World Economic Forum Global Competitiveness Report

★ Global Integrity Index

★ Heritage Foundation Index of Economic Freedom

★ Cingranelli Richards Human Rights Database and Political Terror Scale

★ IFAD Rural Sector Performance Assessments

★ iJET Country Security Risk Ratings

★ Institutional Profiles Database

★ African Electoral Index

★ International Research and Exchanges Board Media Sustainability Index

★ International Budget Project Open Budget Index

★ World Bank Country Policy and Institutional Assessments

★ Political Risk Services International Country Risk Guide

★ Reporters Without Borders Press Freedom Index

★ U.S. State Department Trafficking in People report

★ Global Insight Business Conditions and Risk Indicators

MCC also uses population surveys and surveys of firms that aim to measure topics, including public trust in the financial honesty of politicians; public perceptions of corruption; frequency of bribery by firms; and frequency of corruption among specific public institutions (political parties, legislature, media, the military, education system, legal system, utilities, tax revenue, police, medical services, customs, public officials, etc.). Surveys utilized by MCC include:

★ Afrobarometer

★ Business Enterprise Environment Survey

★ Gallup World Poll

★ Institute for Management and Development World Competitiveness Yearbook

★ Latino-barometro

★ Political Economic Risk Consultancy Corruption in Asia Survey

★ Transparency International Global Corruption Barometer Survey

★ Vanderbilt University Americas Barometer

★ World Economic Forum Global Competitiveness Report

In addition, MCC uses interagency supplemental information and reporting, including from the State Department, USAID, Treasury, and other USG agencies. MCC also may consult with other donors, experts at nongovernmental organizations, academia, and MCA counterparts.

Improving capacity to identify and track patterns of corruption.

Corruption is, by its nature, difficult to measure. MCC's *Control of Corruption* indicator aggregates across data to allow cross-national comparisons that identify the extremely good and extremely poor performers. While this is the function MCC needs the *Control of Corruption* indicator to perform, an indicator of this type is limited in its ability to track specific year-on-year changes, or to be objectively verified by third parties.

By looking at the individual components of the *Control of Corruption* index, MCC is able to draft "Indicator Analyses," which give more detailed snapshots of the status of corruption in countries. These indicator analyses can highlight what individual institutions perceive as year-on-year changes, but they are still limited in their ability to demonstrate clear trends in corruption.

Certain second generation governance indicators—such as the reports produced by Global Integrity or the Open Budget Index—provide more details on specific, objectively verifiable practices or policies in a country. These types of indicators do not measure corruption per se, but rather provide a snapshot of the function of "accountability institutions" in a country that are intended to help fight corruption. The reports and scores for countries on each of these surveys not only track changes over time, but the transparent methodologies enable third parties to understand what specific policy or implementation changes have led to a different scoring.

MCC makes use of these data whenever they are available. Because most actionable governance indicators cover only a limited number of countries, MCC has been encouraging experts in governance to expand the coverage of these indicators. Consistent, iterated and specific measures of performers the function of institutions of accountability would strengthen MCC's ability to identify or track patterns of corruption.

MCC has already begun making selective use of these types of indicators in assessing specific anti-corruption projects. For example, prompted by concerns about corruption levels and trends in Honduras, MCC used data from the Open Budget Index and the World Bank's Public Expenditure and Financial Accountability framework to assess the Government of Honduras's efforts to make its budget process more transparent and accountable. We are hopeful that these types of data will also prompt new thinking and research by experts in the field. MCC has committed to continuing its public consultations with governance experts on this issue.

If improving the capacity of the indicator sources used by MCC is a priority, the U.S. Government could support this type of measure by increasing funding, raising awareness, and encouraging private sources to support this research.

MCC process to determine if level of corruption warrants termination or suspension.

Most countries selected as eligible for MCC funding demonstrate sustained levels of commitment throughout the duration of partnership with MCC. However, when concerns about corruption arise, MCC determines what constitutes a corruption-related "pattern of action" that warrants MCC response, suspension, or termination. MCC's approach to determine a pattern of action is based on consultations with academic and civil society experts (including Transparency International, Global Integrity, and Freedom House) to identify issues and to determine if the corruption environment has deteriorated substantially. There was not a pre-existing consensus among development practitioners or in the academic literature on this topic. We asked experts to help us identify the appropriate issues to watch, when trying to determine if the corruption environment has deteriorated substantially. Based on this expert feedback, MCC follows an approach to monitoring corruption that is in keeping with the agency's eligibility criteria and Suspension and Termination policy. When reviewing whether allegations of corruption suggest a pattern of actions contrary to MCC's eligibility criteria, MCC makes a distinction between two types of corruption:

★ *Incidents of opportunistic corruption driven by individual actors or groups.* This is more likely to represent the actions of individuals, rather than a coordinated government effort. MCC is concerned by these instances, but does not believe that they necessarily represent a fundamental change in levels of corruption in a country.

★ *Government led efforts to undermine institutions of accountability such as courts, anti-corruption commissions, auditors, or the media.* This represents an effort to alter a country's institutional structure in a way that makes individual instances of corruption more likely, enables corruption to flourish, and cultivates a culture of impunity, and is the type of scenario that could contribute to a pattern of actions warranting MCC response, suspension, or termination._

If a partner country's commitment to controlling corruption appears to deteriorate, MCC has several leverage tools including a policy improvement process where MCC staff work with representatives of the government to design, implement, and evaluate actionable steps to improve policy performance. MCC also may issue public or private warnings to the government, make operational implementation adjustments in cases of fraud or corruption within MCC programs, or implement MCC's Suspension and Termination Policy.

Because of the nature of MCC's investments and the limited timelines on which programs operate, suspending or delaying funds is a serious and often irreversible step. Suspension is governed by MCC's policy on Suspension and Termination. This policy and MCC's authorizing statute, provide the right to act, not in the face of individual events, but based on evidence of a "pattern of actions" that represents a decline in the policy areas captured by MCC's scorecard. A decision to suspend or terminate is ultimately taken by MCC's Board.[5]

At the time of writing, MCC's Board has taken action under this policy in eight instances,[6] all of which related to democratic backsliding or coups. While much of what MCC's Board has found to merit a suspension or termination has been directly related to electoral processes or lack thereof, MCC recognizes that accountable governance goes well beyond the transparent and peaceful transfer of elected office.

1   Lambsdorff, Johann. 2003a. How Corruption Affects Persistent Capital Flows. Economics of Governance 4: 229–243. Lambsdorff, Johann. 2003b. How Corruption Affects Productivity. Kyklos 56: 457–474. Pellegrini, L. and R. Gerlagh. 2004. Corruption's effect on growth and its transmission channels. Kylos 57(3): 429–456. Fisman, Raymond and Jakob Svensson. 2007. Are corruption and taxation really harmful to growth? Firm level evidence. Journal of Development Economics 83: 63–75. Friedman, Eric, Simon Johnson, Daniel Kaufmann, and Pablo Zoido–Lobaton 2000. Dodging the Grabbing Hand: The Determinant of Unofficial Activity in 69 Countries. Journal of Public Economics 76: 459–493. Mauro, Paolo 1995. Corruption and Growth. Quarterly Journal of Economics 110:681–712. Kaufmann, Daniel, and Aart Kraay. 2002. Growth without Governance. Economia 3: 169–229. Ciocchini, Francisco, Erik Durbin, and David T.C. Ng. 2003. Does Corruption Increase Emerging Market Bond Spreads? Journal of Economics and Business 55: 503–528. Anderson, Christopher J., and Yuliya V. Tverdova. 2003. Corruption, Political Allegiances, and Attitudes Toward Government in Contemporary Democracies. American Journal of Political Science 47: 91–109. Abed, George T. and Sanjeev Gupta (eds.). 2002. Governance, Corruption and Economic Performance. Washington D.C.: International Monetary Fund. Ades, Alberto, and Rafael Di Tella. 1999. Rents, Competition, and Corruption. American Economic Review 89 (4): 982– 993. Li, Hongyi, Lixin Colin Xu, and Heng–Fu Zou 2000. Corruption, Income Distribution, and Growth. Economics and Politics 12:155–182. Johnson, Simon, Daniel Kaufmann, John McMillan, and Christopher Woodruff. 2000. Why do firms hide? Bribes and unofficial activity after communism. Journal of Public Economics 76: 495–520. Wei, Shang–Jin. 2000. How Taxing is Corruption on International Investors? Review of Economics and Statistics 82:1–11. Del Monte, Alfredo, and Erasmo Papagni. 2001. Public Expenditure, Corruption, and Economic Growth: The Case of Italy. European Journal of Political Economy 17: 1–16.

2   ii Gupta, Sanjeev, Hamid R. Davoodi, and Rosa Alonso–Terme. 2002. Does Corruption Affect Income Inequality and Poverty? Economics of Governance 3: 23–45. Ravallion, M., and S. Chen. 1997. What Can New Survey Data Tell Us About Recent Changes in Distribution and Poverty? World Bank Economic Review 11(2): 357–382Gupta, Sanjeev, Hamid R. Davoodi, and Erwin R. Tiongson. 2001. "Corruption and the Provision of Health Care and Education Services," in The Political Economy of Corruption, edited by Arvind K. Jain. London: Routledge. Mauro, P. 1998. Corruption and the Composition of Government Expenditure. Journal of Public Economics 69: 263–279. Rajkumar, A.S. and V. Swaroop. 2002: Public Spending and Outcomes: Does. Governance Matter? World Bank Policy Research Working Paper 2840. Anderson, James, Daniel Kaufmann, Francesca Recanatini. 2003. Service Delivery, Poverty and Corruption—Common Threads from Diagnostic Surveys. Background paper for 2004 World Development Report. Washington DC: World Bank. Olken, Benjamin. 2006. Corruption and the Costs of Redistribution: Micro Evidence from Indonesia. Journal of Public Economics 90 (4–5): 853–870.

3   The Worldwide Governance Indicators is an aggregate index combining up to 21 different assessments and surveys, depending on availability. The Control of Corruption indicator draws on data, as applicable and available, from the Country Policy and Institutional Assessments of the World Bank, the Asian Development Bank and the African Development Bank, the Afrobarometer Survey, the World Bank's Business Environment and Enterprise Performance Survey, the Bertelsmann Foundation's Bertelsmann Transformation Index, Freedom House's Nations in Transit and Countries at the Crossroads reports, Global Insight's Business Conditions and Risk Indicators, the Economist Intelligence Unit's Country Risk Service, Transparency International's Global Corruption Barometer survey, the World Economic Forum's Global Competitiveness Report, Global Integrity's Global Integrity Index, the Gallup World Poll, the International Fund

for Agricultural Development's Rural Sector Performance Assessments, the French Government's Institutional Profiles Database, the Latinobarometro Survey, Political Economic Risk Consultancy's Corruption in Asia, Political Risk Service's International Country Risk Guide, Vanderbilt University Americas Barometer Survey, the Institute for Management and Development's World Competitiveness Yearbook.

4   For a detailed discussion of the methodology employed for this indicator, please see http://www.brookings.edu/opinions/2010/0924_wgi_kaufmann.aspx.

5   MCC's Board is chaired by the Secretary of State and includes the Treasury Secretary, U.S. Trade Representative, USAID Administrator, MCC's CEO, and four non-government members.

6   In chronological order: Yemen 2005, Gambia 2006, Mauritania 2008, Madagascar 2009, Nicaragua 2009, Armenia 2009, Niger 2009, and Honduras 2010.