

**Report on the
Criteria and Methodology
for Determining the
Eligibility of
Candidate Countries
for
Millennium Challenge
Account Assistance
in Fiscal Year 2012**

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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, 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 2012 (“FY12”) 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 FY12 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 (“the 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 FY12, 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 FY12 MCA assistance.

Criteria and Methodology for FY12

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

1. the country’s overall performance in three broad policy categories—*Ruling Justly, Encouraging Economic Freedom, and Investing in People*;
2. MCC’s opportunity to reduce poverty and generate economic growth in a country; and
3. the availability of funds to MCC.

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 FY12, there will be two groups of candidate countries – low income countries ("LIC") and lower-middle income countries ("LMIC"). As outlined in the *Report on Countries that are Candidates for Millennium Challenge Account Eligibility for Fiscal Year 2012 and Countries that would be Candidates but for Legal Prohibitions* (August 2011), LIC candidates refer to those countries that have a per capita income equal to or less than \$1,915 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 \$1,916 and \$3,975 and are not ineligible to receive United States economic assistance under the same stipulations.

Changes to the Criteria and Methodology for FY12

MCC reviews all of its indicators annually to ensure the best measures are being used and, from time to time, recommends changes or refinements if MCC identifies 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. 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. There have been numerous noteworthy improvements to data quality and availability as a result of MCC's application of the indicators and the regular dialogue MCC has established with the indicator institutions.

MCC also annually reviews the methodology used to evaluate country performance. Since FY04, the methodology has been that the Board considers whether a country performs above the median¹ 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 Control of Corruption indicator. The Board may exercise discretion in evaluating and translating the indicators into a final list of eligible countries and, 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. Where necessary, the Board may also take into account other data and quantitative and qualitative information to determine whether a country performed satisfactorily in relation to its peers in a given category ("supplemental information"). Through this report, the Board publically affirms that it remains strongly committed to identifying countries for MCC eligibility that have demonstrated sound policies in each of the three policy categories.

For FY12, MCC will implement a number of changes that modify the overall evaluation of candidate country performance. While improvements to the selection criteria and methodology are critical, MCC is also mindful of the need to provide countries with a fairly stable set of policy criteria to meet, if MCC is to

¹ The only exception is the Inflation indicator, which uses an absolute threshold of 15% as opposed to the median as its performance standard.

create significant incentives for reform. Therefore, for this year of transition, the Board of Directions will consider countries' performance based on two sets of criteria and methodologies in FY12: the status quo set of indicators and decisions rules, and a revised set. Both of these are outlined below. By encouraging the Board to consider how countries would have performed under the previous system, as well as how countries perform under the new system, MCC will provide a transition year that allows countries to learn how they are being measured, engage in dialogue with MCC about performance, and solicit feedback from the institutions that produce these indicators.

It is important to recognize that all of MCC's indicators have limitations, including these revised indicators. Over the next year, MCC intends to continue working with the indicator institutions to ensure the data and methodology are the best available.

1) Indicators

In FY12 the Board will use two sets of indicators to assess the policy performance of individual countries. These indicators are grouped under the three policy categories listed below. The changes to the revised indicators include one substitution in Ruling Justly; two additions in Economic Freedom; and three substitutions/additions in Investing in People. Specific definitions of the indicators and their sources are set out in the attached Annex A.

Ruling Justly	Economic Freedom	Investing in People
<i>Status Quo</i>		
1. Civil Liberties 2. Political Rights 3. Voice and Accountability 4. Government Effectiveness 5. Rule of Law 6. Control of Corruption	1. Inflation 2. Fiscal Policy 3. Business Start-Up 4. Trade Policy 5. Regulatory Quality 6. Land Rights and Access	1. Public Expenditure on Health 2. Public Expenditure on Primary Education 3. Immunization Rates 4. Girls' Primary Education Completion 5. Natural Resource Management
<i>Revised</i>		
1. Civil Liberties 2. Political Rights 3. Freedom of Information 4. Government Effectiveness 5. Rule of Law 6. Control of Corruption	1. Inflation 2. Fiscal Policy 3. Business Start-Up 4. Trade Policy 5. Regulatory Quality 6. Land Rights and Access 7. Access to Credit 8. Gender in the Economy	1. Public Expenditure on Health 2. Public Expenditure on Primary Education 3. Immunization Rates 4. Girls' Education: 5. Primary Education Completion (LICs) 6. Secondary Education Enrolment (LMICs) 7. Child Health 8. Natural Resource Protection

2) Methodology

Similarly, in FY12 the Board will apply a status quo methodology, and a revised methodology to the respective indicator groupings. These are described below.

Status Quo

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 an absolute threshold 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.

Revised

In making its determination of eligibility with respect to a particular candidate country, the Board will consider whether a country performs above the median or absolute threshold on at least half of the indicators and at least one indicator per category, above the median on the *Control of Corruption* indicator, and above the absolute threshold on either the *Civil Liberties* or *Political Rights* indicators. Indicators with absolute thresholds in lieu of a median include a) *Inflation*, on which a country's inflation rate must be under a fixed ceiling of 15 percent; b) Immunization Rates (LMICs only), on which an LMIC must have immunization coverage above 90%; c) Political Rights, on which countries must score above 17 and d) Civil Liberties, on which countries must score above 25. The Board will also take into consideration whether a country performs substantially worse in any category (*Ruling Justly*, *Investing in People*, or *Economic Freedoms*) than they do on the overall scorecard. Further details on how this methodology differs from the status quo can be found in Annex B.

3) Other Considerations for the Board of Directors

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 worse relative to LMIC countries, than they did compared to other LIC countries, even if in absolute terms they maintained or improved their performance over the previous year. 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.

Supplementary Information

Consistent with the Act, the indicators will be the predominant basis for determining which countries will be eligible for MCA assistance. However, the Board may exercise discretion when evaluating performance on the indicators and determining a final list of eligible countries. Where necessary, the Board also 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. There are elements of the 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. Similarly, MCC may consult a variety of third party sources to better understand the domestic potential for private sector led investment and growth.

The Board may also consider whether supplemental information should be considered to make up for data gaps, lags, trends, or other weaknesses in particular indicators. 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, the Global Integrity Report, and the Extractive Industry Transparency Initiative 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 subsequent compact. In determining eligibility for subsequent compacts, MCC recommends that the Board consider, among other factors, the country's policy performance using the methodology and criteria described above, the opportunity to reduce poverty and generate economic growth in the country, the funds available to MCC to carry out compact assistance, and the country's track record of performance implementing its prior compact. To assess implementation of a prior compact, MCC recommends that the Board 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 core policies and standards.

Continuing Policy Performance

Country partners that are developing or implementing a compact are expected to seek to maintain and improve policy performance. MCC recognizes that country partners may not meet the eligibility 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 to measure performance. None of these factors alone signifies a significant policy reversal nor warrants suspension or termination of eligibility and/or assistance.

However, countries that demonstrate a significant policy reversal may be issued 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” This pattern of actions need not be captured in the indicators for MCC to take action.

Potential Future Changes

MCC will continue to explore potential changes to the indicators for future years. There are important areas of policy performance in which indicators have not yet been developed, or expanded, to the degree needed for inclusion in the MCC selection system. MCC would not envision expanding the number of indicators beyond the current twenty indicators. However, MCC remains interested in indicators that measure policy performance related to educational quality, maternal health, environmental degradation, budget transparency, and more actionable indicators of corruption, which could be used to substitute for existing indicators in the future or as supplemental information. While we have reviewed some indicators with promise - including education policy and quality indicators piloted by the World Bank’s Education for All, measures of maternal health from the World Health Organization or the United Nations (including skilled birth attendants or process indicators regarding access to emergency obstetric care), preliminary data on air pollution provided by NASA satellites, assessments of budget transparency by Open Budget Index, and corruption assessments published by Global Integrity - none of these indicators have sufficient periodicity and country coverage to be incorporated into MCC’s scorecard at this time.

It should be noted that the new Freedom of Information indicator adopted as part of the revised methodology draws on independent, third party data, but is compiled by MCC, similar to how MCC compiles third party data for the Land Rights and Access indicator. MCC welcomes the efforts of third party institutions to improve and publish similar and improved indicators.

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 determine 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 objective indicators. Most are addressed by multiple indicators. The specific indicators appear in parentheses next to the corresponding criterion set out in the Act.

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, and Rule of Law, Gender in the Economy*);

- (B) respect human and civil rights, including the rights of people with disabilities (*Political Rights, Civil Liberties, and Freedom of Information*);
- (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, Freedom of Information, Control of Corruption, Rule of Law, and Government Effectiveness*); and
- (E) combat corruption (*Political Rights, Civil Liberties, Rule of Law, Freedom of Information, 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, Access to Credit, Gender in the Economy, and Regulatory Quality*);
- (C) strengthen market forces in the economy (*Fiscal Policy, Inflation, Trade Policy, Business Start-Up, Land Rights and Access, Access to Credit, and Regulatory Quality*); and
- (D) respect worker rights, including the right to form labor unions (*Civil Liberties and Gender in the Economy*);

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, Girls' Secondary Education, 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 Child Health*); and
- (C) promote the protection of biodiversity and the transparent and sustainable management and use of natural resources (*Natural Resource Protection*).

Annex A: Indicator Definitions

MCC is incorporating six new measures into the selection criteria and dropping two previous measures. MCC's Board of Directors approved these changes for the FY12 selection process, though the Board will also consider how countries perform on the previous set of indicators. This gradual integration of the indicators was designed to provide adequate notice to compact, threshold and candidate countries of the new measures and their performance before the new indicators fully replaced the previous indicators. A brief summary of the indicators follows; a detailed rationale for the adoption of these indicators can be found in the Public Guide to the Indicators (available at www.mcc.gov).

The following 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 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 (status quo indicators only)*: 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)*
4. *Freedom of Information (revised indicators only)*: Measures the legal and practical steps taken by a government to enable or allow information to move freely through society; this includes measures of press freedom, national freedom of information laws, and the extent to which a county is filtering internet content or tools. Source: *Freedom House / FRINGE Special/ Open Net Initiative*
5. *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)*
6. *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)*

7. *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)*

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)*
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*
7. *Access to Credit (revised indicators only)*: An index that rates countries on rules and practices affecting the coverage, scope and accessibility of credit information available through either a public credit registry or a private credit bureau; as well as legal rights in collateral laws and bankruptcy laws. Source: *International Finance Corporation*
8. *Gender in the Economy (revised indicators only)*: An index that measures the extent to which laws provide men and women equal capacity to generate income or participate in the economy, including the capacity to access institutions, get a job, register a business, sign a contract, open a bank account, choose where to live, and travel freely. Source: *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. *Girls Secondary Education (revised indicators only)*: The number of female pupils enrolled in lower secondary school, regardless of age, expressed as a percentage of the population of females in the theoretical age group for lower secondary education. Lower middle income countries (LMICs) will be assessed on this indicator instead of Girls Primary Completion Rates. Source: *United Nations Educational, Scientific and Cultural Organization*
6. *Natural Resource Management (status quo indicators only)*: 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*
7. *Natural Resource Protection (revised indicators only)*: Assesses whether countries are protecting up to 10 percent of all their biomes (e.g., deserts, tropical rainforests, grasslands, savannas and tundra). Source: *The Center for International Earth Science Information Network and the Yale Center for Environmental Law and Policy*
8. *Child Health (revised indicators only)*: An index made up of three indicators: 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*

Annex B: Changes to the Methodology

New Absolute Thresholds

- ★ *Political Rights*: Countries that receive a score above 17 will be considered as passing this indicator. The median will no longer be calculated or utilized.
- ★ *Civil Liberties*: Countries that receive a score above 25 will be considered as passing this indicator. The median will no longer be calculated or utilized.
- ★ *Immunization Rates*: Lower middle income countries (LMICs) that exceed an immunization coverage rate of 90% will be considered as passing this indicator. The median will no longer be calculated or utilized for countries classified as LMICs.

New Democratic Rights Hard Hurdle

In making its determination of eligibility with respect to a particular candidate country, the Board will consider whether a country performs above the thresholds described above on either Political Rights or Civil Liberties.

Require Countries to Pass Half of the Indicators Overall

In making its determination of eligibility with respect to a particular candidate country, the Board will consider whether a country performs above the median or absolute threshold on at least half of the indicators and at least one indicator per category. In order to maintain a focus on the breadth of sound policy performance, the Board will also take into consideration whether a country performs substantially worse on any category (*Ruling Justly, Investing in People, or Economic Freedoms*).

As with the current selection system, the Board may exercise discretion in evaluating and translating the indicators into a final list of eligible countries and, 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. Where necessary, the Board may also take into account other data and quantitative and qualitative information to determine whether a country performed satisfactorily in relation to its peers in a given category (“supplemental information”).

