

The Proposed Millennium Challenge Account Selection Process:
A Comment by the Open Society Institute
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Introduction

The Millennium Challenge Account is a welcome new approach to US foreign aid that will direct significant new funds to poor countries with a demonstrated commitment to sound policies on democracy, economic growth and human development. OSI strongly supports MCA's underlying premise that foreign assistance is most effective when countries have ownership over funds, civil society and the private sector are engaged at the strategic level, and governments are committed to achieving measurable results. To be credible as an incentive-based approach, however, it is critical that the Millennium Challenge Corporation (MCC) exercises careful judgment in selecting eligible countries that truly merit enhanced assistance.

The MCC is currently in the midst of a 30 day public comment period on its criteria and methodology for MCA country selection. The proposed 16 eligibility criteria for FY 2004 are identical to those initially suggested by the Administration in 2003, organized within the 3 broad policy categories of *Ruling Justly*, *Encouraging Economic Freedom* and *Investing in People*.

While these indicators overall emphasize the right policy priorities for countries committed to lasting growth and development, significant data gaps and indicator imprecision require the MCC to take a more qualitative approach to country selection. OSI supports the MCC's recent assertion that it will "look behind the numbers" and make use of other non-quantitative resources on country performance in such critical areas such as gender and corruption, before finalizing country selections. At the same time, it is essential that MCC regulations require that it clearly explain to the public the reasons for using indicators or criteria other than those stated in the final regulations.

Below are OSI's five primary concerns about the MCC's proposed methodology, which focus on I) data sources and grouping II) median flexibility III) a "hard" corruption indicator IV) elevating the role of gender and V) ensuring transparency in the country selection process.

Summary of OSI Recommendations on MCA Methodology:

1. **Data Improvement:** Use the full \$5 million allocated by Congress to develop more accurate and comprehensive data for current indicators, develop better indicators where needed and entirely new indicators where there are none, most notably in the case of gender.
2. **Median Flexibility:** Include countries at, as well as above the median as MCA qualifiers, and establish baseline medians for the current indicators as quickly as possible.
3. **Corruption:** Double-check countries that fail on corruption against alternate sources of information besides the World Bank index, and include participation in the Extractive Industries Transparency Initiative as a criterion under corruption for resource-rich countries.

4. **Gender:** Direct funds towards developing better data/indicators on women, include gender sensitive indicators under “investing in people” such as the maternal mortality ratio and the girls-to-boys ratio in primary school enrollment, and disaggregate country data given to MCC by sex to ensure MCA is working for women/girls.
5. **Transparency:** Provide the public with a rigorous justification for each MCA country ultimately selected, including a detailed explanation of the factors influencing the selection process, with special onus in cases where exceptions to the basic methodology are made.

I. Data Sources and Grouping:

OSI has several concerns regarding the sources and grouping of data. Most notably, there is a scarcity of data for many of the 16 indicators, which unfairly punishes poor countries by failing them in areas where they may actually be good performers but lack quantitative research to show it. OSI urges the MCC to use part of the \$5 million authorized by Congress for “research aimed at improving data related to eligibility criteria” to enhance the limited coverage of country information for the current 16 indicators.

Second, the decision to solicit data on budget deficits and public expenditures on health and education from national governments, rather than the World Bank and/or IMF creates enormous potential for governments to manipulate and falsely report numbers in these areas. If the MCC must source any indicators from national governments, it should verify government data against other independent assessments to ensure the accuracy of these inputs. The MCC must publicly document this process of verification and the sources by which it is done, as a means of both achieving transparency and discouraging government distortion of data.

Finally, OSI recommends that the MCC shifts two indicators, “Rule of Law” and “Government Effectiveness” from the *Ruling Justly* category to the *Economic Freedom* category. All of the factors listed in the *Ruling Justly* category are important, but lumping them together can lead to absurd results like qualifying countries such as Vietnam because they have brutally effective governance. These two indicators seem to more greatly reflect government authority, management and administration than the promotion of human rights. As such, they would arguably fit better under the *Economic Freedom* category, without leading to the perverse result of rewarding governments that suppress freedoms yet make the trains run on time.

II. Median Flexibility:

The MCC proposes to consider only those countries that perform above, and not *at*, the median on half of the indicators within each category. This rigid approach ignores numerous problems associated with the indicators and their methodology. First, the medians for several indicators are based on scant data and use discrete scales (whole numbers ranging from 1-7) with a potentially wide margin of error. Margin of error is a particular concern with corruption, as the accuracy of this one heavily weighted indicator can determine a country’s overall eligibility.

Second, the use of discrete rather than continuous number series results in a large number of countries being clustered around the median, but few actual qualifiers. While it is

desirable and in keeping with the spirit of MCA to reward good performers and create incentives for struggling countries to improve, disqualifying countries equal to the median instead risks eliminating the very sorts of countries the MCA is meant to embrace.

Third, the median is subject to change over time, particularly as countries develop, but also simply by the inclusion of different income levels each year. The MCC must therefore move to establish baseline medians for each indicator as soon as possible, given the problems associated with measuring variously developed countries according to relative performance.

III. A Hard Corruption Indicator and Forms of Assessment:

The MCC proposes to use corruption as a “hard” indicator, meaning that a country which fails on corruption but passes the remaining 15 indicators will be considered ineligible for MCA assistance in 2004. At a March 10th public meeting, the MCC suggested that countries failing the World Bank corruption indicator would not automatically be disqualified, but rather the MCC would take a hard look at other sources of information, such as the Transparency International Corruption Perceptions index, to ensure a fair and accurate appraisal of a country’s performance in this area. OSI supports this case-sensitive approach as the best way to promote a zero-tolerance policy on corruption while insuring that countries with a track record of improvement in this area are recognized.

As part of this qualitative assessment, OSI also recommends that for resource-rich countries, the MCC includes the government’s adherence to the tenets of the Extractive Industries Transparency Initiative (EITI), which the US Government has endorsed. EITI demands full transparency of payments made by companies to governments for access to their resource sector, and full transparency of revenues received by those governments. Resource-rich countries have been the poorest performers on growth and development over the last 40 years, in no small part due to the capture of resource revenues by political elites.

IV. Elevating the role of Gender:

While the MCA law requires that the country selection process takes the treatment of women into account, the MCC proposes no separate indicator for gender. Instead, the MCC submits that the board “may rely” on supplemental data on the treatment of women “where necessary” when assessing country performance. This data includes the level and trend in girls’ primary school enrollment, and the status of women as described in the State Department Human Rights country reports.

Given the lack of a well-developed women’s indicator at present, OSI urges the MCC to commit all necessary funds to developing such a measure as soon as possible. In the meantime, as recommended by numerous civil society groups, the MCC should include two additional “gender-sensitive” indicators under *Investing in People*, which is currently the only category with four rather than indicators. Two relatively well-developed indicators of this kind are the maternal mortality rate and the girls-to-boys ratio in primary school enrollment. Finally, MCC contracts should require that all national data is

disaggregated by sex in the grant evaluation process, and the MCC should include extra funds to help countries accomplish this if necessary. Such reporting is the only means to ensure that MCA is working for women and girls.

Each MCA indicator represents a key priority for US Government in the policies of the countries it assists. The creation of such incentives is one of MCA's most powerful tools, and the presence of gender-based indicators will encourage MCA candidate countries to improve their treatment of women where they may not otherwise.

V. Ensuring Transparency in the Country Selection Process:

Transparency in the MCC's selection process is critical to insuring that countries have a clear understanding of the standards against which their policies are being measured, and poor performers have compelling incentives to improve. The MCC must publish widely, including on the internet, the reasons why individual countries are accepted and rejected regarding eligibility for MCA funding. There is a special obligation to be thorough in cases where exceptions to the 16 basic criteria are made. All documents, including MCC contracts, MCC grants and MCC performance evaluations, should be posted. Full transparency is also the best means to both realize and legitimize MCA's apolitical aspirations.