

## **2004 MCA Threshold Program: A Comment on Country Selection**

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On September 30, 2004, the Millennium Challenge Corporation (MCC) named seven countries as eligible for the MCA Threshold Program – Albania, East Timor, Kenya, Sao Tome e Principe, Tanzania, Uganda and Yemen. This note reviews the countries selected and the selection process, and makes three key points about the Threshold Program more broadly:

1. The MCC should make much clearer its rationale for the selection and exclusion of countries from the Threshold Program. The MCC's stated methodology for the selection of program countries does not fully explain the resulting list of countries. Board discretion was clearly applied and the reasons for this should be made public.
2. Selection of the Threshold countries should be made at the same time as the selection of MCA- eligible countries to ensure consistency and transparency in the application of criteria and Board discretion.
3. The funding allocation for the Threshold Program is inadequate to help countries make sufficient improvement in the indicators to qualify for the MCA.

### **Overview of the Threshold Program**

**Objective:** According to the MCC the Threshold Program is “designed to assist countries that are on the ‘threshold,’ meaning that they are committed to undertaking the reforms necessary to improve policy performance and eventually qualify for MCA assistance.”

**Country Selection:** The methodology used to select Threshold Programs is stated by the MCC as follows:

In considering countries for the FY04 Threshold Program, the Board favored countries that had to improve upon two or fewer indicators to qualify cleanly under the MCA eligibility criteria; i.e., by improving on two or fewer indicators the country would score above the median on half of the indicators in each policy category, would score above the median on the corruption indicator and would not score substantially below the median on any indicator. In addition, the Board reviewed whether countries that passed this screen also demonstrated a commitment to undertake policy reforms that would result in improvements in deficient MCC policy indicators.

**Administration:** Unfortunately, even after months of debate, few details have been made public on how the program will be administered, and many questions remain unanswered.

The Threshold Program will be managed mainly through a partnership between the MCC and USAID, with assistance used “to help countries address the specific policy weaknesses indicated by the country’s scores on the sixteen policy indicators that are central to the MCA eligibility criteria and methodology.” This program will differ from existing USAID programs in that eligible countries are invited to write proposals to apply for funding, with the proposals assessed “based on the political commitment of each country to undertake reforms.”

**Funding:** The MCC has allocated up to \$40 million for the Program for 2004, though the authorizing legislation allows for up to 10% of annual MCA funding – that is, \$100 million for 2004 – to be dedicated to the Threshold Program. The \$40 million allocated for the seven countries in the program – less than \$6 million per country -- is almost certainly inadequate to meet the program’s objectives.

### **Three Early Problems**

The Threshold Program faces three problems in its early stages, aside from the lack of detail on its administration and its inadequate funding.

**Timing:** The MCC Board selected the Threshold Program countries five months after it selected countries for the first year of the MCA. It is hard to understand why this decision was delayed for so long. Ideally the decisions surrounding these two selection processes would occur simultaneously, especially considering the number of countries that are on the borderline of MCA eligibility. The line between MCA-eligible countries and Threshold countries is in many cases very thin. The Board uses the exact same information in determining the two country lists, and everything it needed to make the Threshold country decisions should have been available in May. Threshold countries were forced to wait several additional months, as governments (and the general public) in these countries were first told that they were ineligible, and then told four months later that actually they were eligible for the Threshold Program. Perhaps most importantly, their programs lost valuable time getting off the ground, with nothing gained by the delay. Especially since Board discretion is needed to determine both the MCA-eligible and Threshold-eligible countries, it would make much more sense for the Board to make one set of decisions each year to classify all candidate countries as either (a) MCA-eligible, (b) Threshold-eligible, or (c) ineligible. This would ensure greater consistency and transparency in the Board’s decisions.

**Moving medians:** There is a basic flaw in the original design of the MCA that undermines the ability of the Threshold Program to meet its objective of ensuring that more countries meet the standards necessary to qualify for the MCA. The basic standard for satisfactory performance on any indicator for the MCA is the median score. However, as Threshold countries improve their performance in any area, the median score will rise, dropping other countries below the qualifying criteria. More broadly, as long as the median scores continue to be used as the qualifying standard, the number of qualifying countries will be limited to approximately the same number, even if all candidate countries improve their performance. This is just one of several reasons why the MCC

should move away from using median scores to using absolute levels as the qualifying criteria, at least where possible. The MCC now does this with inflation, and should immediately do the same for immunization rates, school completion rates, the three budget-related indicators, days to start a business, and perhaps other indicators. Medians force countries to aim at moving targets and imply ever-changing standards for minimum satisfactory performance.

**Inconsistencies in Board discretion:** One of the criterion used by the Board in choosing the Threshold countries was that, after improvement in no more than two indicators, country scores must not be “substantially below” the median on any indicator. Although it has not defined “substantially below,” by any definition this standard has been used inconsistently. For the purposes of this analysis we define “substantially below” the median as scoring below the 25<sup>th</sup> percentile (altering this standard does not significantly change our conclusions). Using this definition, it is clear that some of the countries chosen for the MCA in May scored very poorly on some indicators and nevertheless were chosen for the MCA, while some of the countries left out of both the MCA and the Threshold programs did not score substantially below the median on any indicators. Some of the Threshold countries fall substantially below in more categories than do those countries excluded from the program. For example, Bosnia and Herzegovina, Moldova and Tonga (each excluded from the Threshold program) do not score substantially below the median on any indicator, while East Timor, Kenya and Yemen fall substantially below the median on at least two indicators and nevertheless were selected for the program (see Table 1). While Board discretion is a necessary part of the selection process, a more transparent definition of “substantially below” is needed. Where the Board varies from this standard it should provide a public explanation in order to uphold the MCA’s basic principle of transparency.

### **Countries Selected for the Threshold Program and Other Reasonable Candidates**

There are about 20 countries that missed MCA eligibility by one indicator, and six that missed by two.<sup>1</sup> Of these 20, seven were selected for the Threshold Program (and two were selected for the MCA itself – Bolivia and Georgia). It is important to note that *missing* MCA eligibility by one or two indicators is not the same as the Threshold Program criterion of only needing to *improve* in one or two indicators to be eligible. This is because of the Threshold requirement that countries not score “substantially below” the mean on any indicators. If, for example, a country missed MCA eligibility only by one indicator, it could have passed seven hurdles cleanly but be substantially below the median on up to eight others. To repeat, according to the MCC, countries selected for the Threshold Program should require improvement in only two indicators to be able to: 1) clear half of the indicators in each category; 2) pass the hard hurdle of corruption; and 3) not be substantially below on any other indicators.

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<sup>1</sup> See: Qualifying for the MCA: An Update, Steve Radelet. Center for Global Development, April 2004. <http://www.cgdev.org/Publications/?PubID=100>

We group countries into three categories and describe each in turn:

1. Countries chosen for the Threshold Program that need to improve on one indicator: Albania, and Sao Tome e Principe.
2. Countries chosen for the Threshold Program that need to improve on two indicators: East Timor, Kenya, Tanzania, Uganda, Yemen.
3. Countries not chosen for the Threshold program that appear to meet the MCC criteria: Bosnia and Herzegovina, Kiribati, Moldova, Nepal and Tonga.

### **Threshold Countries that need to improve in one indicator**

**Albania** passed enough indicators to be deemed eligible for the MCA but was eliminated by corruption, scoring just below the median (45<sup>th</sup> percentile). It does not score substantially below on any hurdles. On the surface, this makes Albania a good candidate for the Threshold Program. However, Albania is an odd choice because 2005 data indicate that its per capita income has risen above the MCA ceiling of \$1,465, so that it is no longer in the pool of MCA candidate countries. Looking forward, if the MCC expands again to include middle income countries as a separate candidate pool in 2006 (something the current budget would probably render infeasible), Albania will again become a candidate country, albeit in a different pool. It is obviously way too early to determine the standards necessary for a country to be on the threshold for qualifying in the middle income group for 2006, so it seems premature to include Albania in this group.

**Sao Tome and Principe** passes all of the “ruling justly” hurdles and three of four “investing in people” indicators. In “economic freedom” Sao Tome and Principe passes only two hurdles, although it misses two others simply because the data are missing (trade policy and days to start a business). It falls “substantially below” on just one hurdle – the fiscal deficit. However, this is at least partly due to problems in the measurement of the indicator rather than Sao Tome’s performance – the country receives large aid flows through its budget, which increases the budget deficit, at least by the definition of the deficit used by the MCA.<sup>2</sup> A more appropriate definition would measure the deficit after the receipt of concessional aid flows.

Sao Tome and Principe is also missing data in three indicators. This raises the question of how missing data is used in the selection of Threshold countries. The Board seems to have considered the country’s missing data when it did not select Sao Tome for MCA-eligibility, but in effect ignored it in choosing the country for the Threshold Program (since if missing data were considered “substantially below” the median, Sao Tome would be “substantially below” the median on several indicators). The MCC should clarify its treatment of missing data for both selection processes.

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<sup>2</sup> When an aid receipt goes through the budget and is used, for example, to purchase vaccines, the vaccine purchases count as an expenditure, raising the deficit, and the aid inflow counts as “below the line” financing (i.e. it is not counted as revenue).

## **Threshold countries that need to improve on two indicators**

**East Timor** does very well in governance, missing just one of the “ruling justly” indicators and cleanly passing the corruption hurdle. It scores substantially below the median in three indicators – 25<sup>th</sup> percentile in rule of law, 19<sup>th</sup> percentile in immunization rates, and 12<sup>th</sup> percentile on regulatory policy. East Timor passes just two of six “economic freedom” indicators, but misses two because of missing data. The fact that the country was selected despite this highlights again how missing data are considered in Threshold selection. Missing data for East Timor is not surprising, since it just became an independent nation in May 2002.)

**Kenya** misses four of six “ruling justly” indicators, though only one score falls substantially below the median – control of corruption in the 20<sup>th</sup> percentile. It misses two hurdles in “investing in people” but is relatively close to the median (40<sup>th</sup> percentile) in both. It misses another two in “economic freedom”, including one (trade policy) that is substantially below the median. Thus it falls substantially below the median on two indicators: control of corruption and trade policy.

**Tanzania** missed MCA selection because it fails the hard hurdle of corruption – falling in the 30<sup>th</sup> percentile in this criterion. It misses one additional indicator in each category, falling into the worst possible percentile on trade policy. Thus, like Kenya, it falls substantially below the median on two indicators: control of corruption and trade policy

**Uganda** is a particularly interesting case. It fails five of six “ruling justly” indicators, including control of corruption and the three measures of democracy. The MCC appears to have applied a soft hurdle of democracy in selecting MCA countries, eliminating three countries that passed the strict indicators test but are not democracies. Yet it selected Uganda for the Threshold Program, presumably because Uganda does not score substantially below the median on any indicator. It also has a strong reputation for using aid effectively. To pass the strict MCA criteria, it would have to improve its score on corruption and one other governance indicator.

**Yemen** is similar to the case of Uganda in that it fails five of six “ruling justly” indicators, including all three of the democracy hurdles. However, it scores substantially below the median on two of the governance indicators – in the 16<sup>th</sup> percentile on civil liberties and in the 18<sup>th</sup> percentile on rule of law. These are by far the lowest governance scores of any of the Threshold countries, and lower than several countries that were not chosen for the Threshold program (see table 1). Yemen does meet the basic criteria laid out for the Threshold program, but several countries with even better scores were left out of the program (see next section). This has led to some speculation that Yemen was included partly for political reasons as a reward for its strong support for the U.S. in the war on terrorism. To the extent this is the case, the U.S. should provide its support through the State Department’s Economic Support Fund, rather than the MCC (a similar argument has been made for Georgia).

## **Countries not chosen for the Threshold Program that appear to meet the criteria**

According to selection methodology, to be selected for the Threshold Program countries need to make improvements in no more than two indicators. This is the case for several countries that were not chosen for the program, despite having scores that are better than some of the countries chosen. It may be perfectly appropriate for the Board to make these choices, but when it deviates from its stated methodology it should make its rationale publicly available. To not do so may be within the law, but it undermines one of the great strengths of the MCC – its transparent and rational selection process.

**Bosnia and Herzegovina** missed MCA eligibility by one indicator in the “ruling justly” category and would have been deemed eligible if being on the median counted as a passing score. It does not score substantially below on any of the indicators and clears the corruption hurdle. Its scores are clearly superior to many of the countries chosen for the Threshold Program.

**Kiribati** missed MCA eligibility by just one indicator but is substantially below the median in two – 1<sup>st</sup> percentile on fiscal policy and 22<sup>nd</sup> percentile in regulatory quality. It passes all of the hurdles in the “ruling justly” category, and two each in the “investing in people” and “economic freedom” categories.

**Moldova** was eliminated from MCA eligibility by corruption. It misses just four hurdles overall, two in “ruling justly” -- including control of corruption on which it scores in the 41<sup>st</sup> percentile, and one each in “investing in people” and “economic freedom”. It does not score substantially below the median in any indicator.

**Nepal** missed MCA eligibility by one indicator in the “investing in people” category and scores substantially below the median in two areas – 17<sup>th</sup> percentile in health spending and in the worst percentile in trade policy. While there are genuine political concerns that would make Nepal a questionable choice for the Program, the Board should make clear its use of discretion.

**Tonga** missed MCA eligibility by one indicator in the “economic freedom” category (at least according to one of the two MCC data sources).<sup>3</sup> It clears the corruption hurdle and does not score substantially below the median on any of the indicators. Like Sao Tome and Principe and East Timor above, Tonga is missing data – in this case in four indicators, three of which are in the “economic freedom” category.

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<sup>3</sup> The MCC data on Tonga are inconsistent. According the country specific spreadsheets, it passed enough hurdles to qualify for the MCA in FY n’04. According to the Excel spreadsheet file on the MCC website with all data from all countries, Tonga falls one hurdle short. We have used the latter as our main source.

## **Outstanding Issues**

To some degree, the naming of the Threshold-eligible countries is the easiest step. Almost a year after the authorization of the Threshold Program almost all operational details remain unclear. Among the questions that have yet to be answered about the Threshold Program are:

- What will be the role of USAID and other USG agencies in selecting and implementing country programs funded under the Threshold Program? How will the proposal process work? To whom will the countries submit proposals, and who will review them? On what criteria will reviewers select winning programs? What will be the relationship between Threshold-funded programs and USAID programs in countries?
- Will Threshold countries enter into country compacts as MCA countries will do? If so, what will be their duration? Will countries be funded only for programs within the category in which they failed to pass the hurdles test?
- How will success be measured in the Threshold Program? Will recipients or the MCC/USAID be responsible for defining program objectives and benchmarks for success? Who will conduct monitoring and evaluation of Threshold-funded programs?
- Will there be a role for civil society in Threshold Program countries as there is in the setting of priorities in MCA-eligible countries? If so, at what phase will civil society input be solicited?

**Table 1. Threshold Countries and the Use of Board Discretion**

*"In considering countries for the FY04 Threshold Program, the Board favored countries that had to improve upon two or fewer indicators to qualify cleanly under the MCA eligibility criteria; i.e., by improving on two or fewer indicators the country would score above the median on half of the indicators in each policy category, would score above the median on the corruption indicator and would not score substantially below the median on any indicator. In addition, the Board reviewed whether countries that passed this screen also demonstrated a commitment to undertake policy reforms that would result in improvements in deficient MCC policy indicators."*

	FY 2004 indicators (numbers in parentheses indicate percentile rank)	
	at the 25th percentile or below	between the 25th and 50th percentile
<b>Threshold countries</b>		
Albania	--	Rule of law (34.2) <b>Control of corruption (45.2)</b> Primary education spending (41.4) Country credit rating (47.2) Fiscal deficit (25.3) Trade policy (37.5)
East Timor	Rule of law (24.6) Immunization rate (19.1) Regulatory policy (12.3) Trade policy (n.a.) Days to start a business (n.a.)	Government effectiveness (47.9) Primary education completion (37.8) Country credit rating (38.8)
Kenya	<b>Control of corruption (20.5)</b> Trade policy (0-37.5)	Voice and vote (46.5) Government effectiveness (34.2) Rule of law (27.3) Primary education completion (46.9) Health spending (40.8) Fiscal deficit (47.8)
Sao Tome e Principe	Fiscal deficit (2.8) Trade policy (n.a.) Days to start a business (n.a.)	Country credit rating (40.2)
Tanzania	Trade policy (0-37.5)	Political rights (49.3) <b>Control of corruption (30.1)</b> Primary education completion (45.4)
Uganda	--	Political rights (36.9) Civil liberties (41) Voice and vote (39.7) Rule of law (41) <b>Control of corruption (35.6)</b> Health spending (28.1) Immunization rate (47.9) Fiscal deficit (46.4)
Yemen	Rule of law (17.8) Civil liberties (16.4)	Political rights (36.9) Voice and vote (36.9) Government effectiveness (31.5) Primary education completion (39.3) Immunization rate (43.8) Days to start a business (32.6)
<b>Qualified for FY 2004 funds through the use of Board discretion</b>		
Bolivia	Fiscal deficit (15.4)	<b>Control of corruption (49.3)</b> Days to start a business (40.3)
Georgia	Rule of law (21.9) <b>Control of corruption (23.2)</b> Primary education spending (7.1) Health spending (7)	Political rights (49.3) Civil liberties (41) Country credit rating (37.5) Trade policy (37.5) Regulatory quality (41)
<b>Countries not chosen for the Threshold Program that appear to meet the MCC criteria</b>		
Bosnia and Herzegovina	--	Political rights (49.3) Civil liberties (41) Government effectiveness (26) Rule of law (35.6) Regulatory quality (32.8)
Moldova	--	Civil liberties (41) <b>Control of corruption (41)</b> Primary education spending (27.1) Country credit rating (45.8)
Kiribati	Fiscal deficit (1.4) Regulatory policy (21.9) Primary education completion rate (n.a.) Trade policy (n.a.) Days to start a business (n.a.)	Health spending (36.6)
Nepal	Health spending (16.9) Trade policy (0-37.5)	Political rights (36.9) Civil liberties (41) Primary education spending (47.1) Immunization rate (46.5)
Tonga	Primary education completion rate (n.a.)	Political rights (36.9)



<b>FY 2004 indicators (numbers in parentheses indicate percentile rank)</b>		
	<b>at the 25th percentile or below</b>	<b>between the 25th and 50th percentile</b>
	Trade policy (n.a.)	Regulatory quality (36.9)
	Days to start a business (n.a.)	
	Country credit rating (n.a.)	
<b>Missed MCA standards by one indicator</b>		
Burkina Faso	Primary education completion rate (7.5) Immunization rate (6.8) Days to start a business (11.5)	Political rights (49.3) Civil liberties (41) Country credit rating (47.2) Fiscal deficit (45) Trade policy (37.5)
Bangladesh	<b>Control of corruption (12.3)</b> Primary education spending (17.1) Health spending (22.5) Trade policy (0-37.5) Regulatory policy (24.6)	Political rights (49.3) Civil liberties (41) Voice and vote (49.3)
Indonesia	<b>Control of corruption (9.5)</b> Primary education spending (10) Health spending (5.6) Days to start a business (5.7)	Civil liberties (41) Rule of law (45.2)
Malawi	Country credit rating (23.6) Fiscal deficit (19.7)	Civil liberties (41) <b>Control of corruption (36.9)</b> Immunization rate (42.4)
Djibouti	Civil liberties (16.4) Primary education completion rate (13.6) Trade policy (0-37.5) Days to start a business (n.a.)	Political rights (36.9) Voice and vote (43.8) Government effectiveness (30.1) Immunization rate (39.7) Regulatory quality (45.2)
India	Fiscal deficit (7) Trade policy (0-37.5) Days to start a business (21.1)	Primary education spending (30) Health spending (30.9) Immunization rate (45.2)
<b>Missed MCA standards by two indicators</b>		
Eritrea	Voice and vote (0) Civil liberties (4.1) Political rights (0) Primary education completion rate (21.2) Country credit rating (16.6) Fiscal deficit (0) Regulatory policy (20.5) Trade policy (n.a.) Days to start a business (n.a.)	--
Pakistan	Civil liberties (16.4) Political rights (9.5) Primary education spending (15.7) Health spending (8.4) Trade policy (0-37.5)	Voice and vote (26) Primary education completion (42.4) Immunization rate (34.2) Regulatory quality (43.8)
Rwanda	Voice and vote (12.3) Civil liberties (16.4) Political rights (9.5) Primary education completion rate (10.6) Country credit rating (8.3)	Government effectiveness (38.3) Rule of law (28.7) Health spending (45) Regulatory quality (31.5)
Sierra Leone	Rule of law (16.4) Government effectiveness (4.1) Primary education completion rate (16.6) Primary education spending (5.7) Health spending (21.1) Immunization rate (24.6) Country credit rating (6.9) Fiscal deficit (8.4) Trade policy (0-37.5) Regulatory policy (9.5)	Political rights (49.3) Voice and vote (47.9)
Togo	Government effectiveness (16.4) Voice and vote (17.8) Civil liberties (16.4) Political rights (9.5) Health spending (23.9) Country credit rating (23.6)	Primary education completion (48.4) Immunization rate (36.9) Days to start a business (46.1)

Note: Percentile scores are "n.a." when data are missing.