On Eligibility Criteria for the Millennium Challenge Account

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In Brief:
We define two distinct and overarching objectives for the MCA, and in light of these objectives, propose 12 criteria for assessing potential recipient country eligibility. We recommend that the MCA be targeted to the poorest countries that are eligible for World Bank grants and concessional loans.

The two objectives are:

- Achieve the greatest possible impact on economic growth and poverty reduction for each development aid dollar.
- Support long-term movement toward leadership that respects human rights and the rule of law, and is fundamentally concerned with improving its citizens' well-being.

The 12 eligibility criteria are:

Ruling Justly
1. The judiciary is independent.
2. A free press exists.
3. Trade unions, peasant organizations or equivalents, and professional and other private organizations are permitted to exist freely.
4. The head of state or other chief authority is elected though free and fair elections.
5. The head of state or other chief authority has been in power for less than 15 years.
6. The national budget is transparent and publicly available.
7. Public administration is free of corruption.

Economic Freedom
8. The three-year moving average for inflation is less than 20 percent.
9. Weighted average tariff rates do not exceed 35 percent.
10. Regulation on business is not overly burdensome.

Investing in People
11. DPT3 coverage is greater than 50%.
12. Non-salary spending on basic education per school-aged child amounts to at least 10 percent of government revenue.

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ON ELIGIBILITY CRITERIA FOR THE MILLENNIUM CHALLENGE ACCOUNT

How will the U.S. government determine which countries are eligible for funding under the proposed Millennium Challenge Account (MCA)? In this note, we proceed on the premise that the eligibility issue can best be addressed by starting with a clear understanding of the objectives of the MCA, and then making an explicit link between those objectives and the criteria themselves. To be specific (and, we hope, helpful to the Administration, to Congress, and to the development community concerned with ensuring best use of the MCA funds), we propose a set of one dozen technically sound eligibility criteria that would reinforce MCA objectives, and be feasible given the reality that income-poor countries also tend to be data-poor.

It is not possible to discuss eligibility criteria in the abstract. In an initial note dated May 22, 2002 on the MCA, Birdsall, Lucas and Shah set out principles for the design and implementation of the MCA, and outlined a specific operational approach consistent with those principles (see Appendix A). In the light of those principles and that particular operational example we now suggest specific criteria. To recap briefly the operational approach: It consists of two stages. In the first stage countries would be deemed eligible (or ineligible) to submit proposals to a second-stage competition. In the second stage, technical board(s) would rank program proposals, and U.S. government officials would make final decisions about which proposals would be funded, guided by the views of the technical boards.[1] In this approach, the eligibility criteria are used not for the final resource allocation decision, but rather to distinguish between those countries that can enter the competition for funding and those that cannot, in a given funding round.

Objectives of the MCA

What would it take for an observer to say – in five or ten years – that the MCA has been successful? In other words, what are the essential objectives of the MCA? One clear response to that question is that the MCA is *not* intended to fulfill all the possible aims of development assistance in general. Administration officials have repeatedly indicated that the MCA is to be considered as one part of a larger foreign assistance program, and not one that is aimed at reinforcing strategic trade and/or security alliances, or providing humanitarian relief in cases of natural disaster or conflict.

[1] We acknowledge the legitimate concern that this could impose an additional burden on the applicant countries. As we noted in Birdsall et al. (May, 2002, attached as Appendix A), it also ensures recipient countries will have ownership of the programs that are funded. Moreover, countries need not necessarily prepare special new requests for MCA funding; they could request MCA funding for existing strategies and programs, including those set out already in PRSPs (Poverty Reduction Strategy Papers), Education for All programs, programs prepared for the Global Health Fund and so on.

Drawing from official statements about the MCA (see Appendix B), including the useful "MCA Fact Sheet" prepared by the Bush Administration, as well as the broader dialogue in the advocacy community, we suggest two conceptually distinct objectives:[2]

<u>Objective 1. Achieve the greatest possible impact on economic growth and poverty reduction for each development aid dollar</u>.

The concept of the MCA originated with the convergence of three factors: First, the observation that traditional development aid has produced disappointing results in terms of economic growth and reduction of income poverty.[3] Second, an influential body of economic research that connected the effectiveness of development aid (as measured by its impact on economic growth) to reasonably sound economic management and policies in the recipient countries.[4] Third, an expanding recognition that the future of the U.S. depends, in part, on improving the conditions for the poor in developing countries. These factors led to the creation of the MCA as a large new aid program focused on growth and poverty reduction,[5] that would avoid the failures of past aid programs by providing assistance only to countries in which existing conditions favor its effective use.

The basic implications for the choice of eligibility criteria are clear: The criteria must rule out countries in which aid is likely to be wasted, either directly (through corrupt practices) or indirectly (through gross inefficiencies in public service delivery, widespread disincentives for domestic private sector investment, and so forth). The criteria must also send a signal to all countries about the policies and practices that can be adopted to increase the potential for aid to be effective toward the ends of economic growth and poverty reduction; they should indicate to the countries that are currently ineligible what steps could be taken to become eligible.

[2] In his speech announcing the MCA, President Bush set out three bases for judging country eligibility: ruling justly, economic freedom and investing in people. Our two objectives are not in themselves bases for eligibility but go one level deeper in an effort to extract the underlying objectives of the proposed program.
[3] We use the expression "income poverty" because development aid has been more successful in reducing other types of "poverty," such as lack of health and education. Indicators of health and education have increased substantially in the developing world in the last four decades, even where incomes have not increased much if at all.
[4] For example, World Bank, 1998 (*Assessing Aid: What Works and What Doesn't);* Burnside and Dollar, 2000. There is in fact considerable disagreement about the merits of some of the measures of sound economic policy (such as openness to trade) used in these studies, and also about the robustness of the connection between "good policy" and aid effectiveness. See, for example, the 2001 book *Changing the Conditions for Development Aid: A New Paradigm?*, edited by Niels Hermes and Robert Lensink. However there is no question that the alleged link, which makes such good sense intuitively, is a basis for the MCA.
[5] President Bush referred to the Millennium Development Goals (MDGs) in his speech, which are internationally agreed goals for reduction of poverty and progress in health, education and other areas. We intend our framing of this first objective to be consistent with and to reinforce the MDGs.

Objective 2. Support long-term movement toward leadership that respects human rights and the rule of law, and is fundamentally concerned with improving its citizens' well-being.

In much of the debate around the design of the MCA, particularly within the advocacy and activist community, the program is seen as an opportunity for the U.S. government to break with its history of supporting unsavory leaders for the sake of this country's strategic interests. The MCA is intended, then, to support governments that have good leadership, a positive record on human rights, and a meaningful commitment of their own organizational and financial resources to health, education, and other programs that respond to citizens' needs. More generally, these are the kinds of governments that visibly adhere to the U.S. public's vision of what makes a good partner, a model for neighboring countries.

Although arguments can (and have) been made that link respect for human rights to long-term prospects for economic growth, attention to what might be called the ethical dimension of the MCA is not precisely the same as attention to the economic dimension. It is possible to identify countries with the conditions that favor economic growth (at least in the short term), but where freedom of speech and freedom of association routinely are curtailed, and where elections are neither free nor fair. Similarly, it is possible to cite countries where the current leadership appears to be establishing a positive human rights record, but where dysfunctional economic policies would likely limit the potential for economic growth, regardless of aid flows.[6] Thus, criteria reflecting both objectives, if necessarily separately, need to be outlined.

Practical Implications for Eligibility Criteria

In his speech proposing the MCA, President Bush stipulated that the MCA select grant recipients on the basis of "clear and concrete and objective criteria." "Objectivity" in this instance does not mean that value judgments are absent; in fact, under each of the substantive areas there is no escaping from the imposition of value judgments, which one would expect to reflect the prevailing ethos of the U.S. taxpayers (through their Congressional representatives and the "voice" on these issues they exercise through various civil society groups). What "objective" does connote in the context of the MCA is a consistent and accessible (or understandable) application of eligibility criteria, so that countries designated as eligible or ineligible in any given year understand on what grounds the eligibility has been determined – and they (and their citizens) know what needs to be done to stay or get on the list in the future.[7]

What are the technical implications of these "criteria for eligibility criteria"? They are that the criteria for country eligibility should be:

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[6] For more on this question, see Rodrik, 1997.

[7] This would be a radical change from the current U.S. aid program, in which countries' receipts of net transfers fluctuated due to volatile strategic interests, changing bureaucratic arrangements, and of course changes in availability of funds.

- Single-variable indicators. If the Administration is seeking to communicate accessible concepts to the American taxpayer and to the citizens, civil society groups, the press, and the governments of potential recipient countries, then the substance of the criteria must be intuitively obvious. A single-variable indicator is far preferable to a composite index, in which interpretation of the ranking or score requires close study of thick reference materials. Fortunately, in many cases simple-to-explain single-variable indicators are good proxies for a large constellation of other variables of importance. Immunization coverage, for example, is highly correlated with overall functioning and responsiveness of the government health system. At the same time, we recognize that established composite indices of important variables may be the only way to capture the essence of a particular concept, such as "level of corruption," so the "no index" guideline cannot be hard and fast.

- Few in number, and related to already widely accepted indicators, for the same reasons.

- Absolute rather than relative measures. Many criteria can be formulated either as an absolute standard (for example, spending on basic education more than 20 percent of total government spending); or in relative terms (for example, country spends more on basic education than any other country in comparable income group). With few exceptions, criteria will work better if they are established as absolutes; this approach has the greatest potential to send a strong signal, eliminates the need to compare across very different country settings, and does not require establishing a target number (or percent) of eligible countries *ex ante*.

- Relatively "generous," including more than excluding countries in our first stage. For two reasons, we recommend setting the threshold or cutoff value for the criteria at a level consistent with minimum standards; all countries are eligible to compete in the second stage of the allocation process if they meet these minimum standards. First, being more inclusive through the use of relatively generous thresholds reflects a recognition that we are unable to predict with certainty what makes countries succeed while others fail. As many observers have noted, 30 years ago South Korea would not have been seen as a likely star, and would have failed to pass many of the hurdles now being considered as MCA criteria. Second, under a competitive two-stage process, having a wider group of countries from which to select the final "winners" helps to manage the potential difficulty of delivering a large volume of aid.

- All or nothing. To be eligible, a country would have to pass *all* of the criteria, rather than 3 of 5, 7 of 10, or some other permutation. This eliminates the otherwise inevitable debates about which criteria are more important, and permits the program to accommodate two (or more) objectives that may not be fully aligned, as described earlier. A country would have to be *both* likely to use aid dollars well *and* demonstrate a good human rights record. The "all or nothing" approach, in turn, also reinforces the notion that the thresholds should be relatively generous (i.e., low), to avoid being in the situation where an otherwise high-performing country was eliminated because of a single failing.

- Focused on the recent past, e.g. the last three years. Many countries in the developing world have dynamic and uneven records with respect to both economic policies and respect for human rights. Sudden changes often occur with political transitions, in the face of shifts in global markets, or because of the vicissitudes of donor behavior. For this reason, it is not particularly useful to permit or restrict access to the MCA based on criteria that reflect a lengthy historical process and/or long lag times between the introduction of appropriate policies and the positive outcomes sought. For example, the female literacy rate, which may be an excellent long-term indicator of prospects for development, would be a relatively poor criterion to distinguish between countries that are "investing in people" and those that are not. In contrast, increases in spending non-salary inputs to basic education may be closer to the mark.

Finally, the selection of criteria must be informed by an understanding of the characteristics of the available data. Ideally, the data would meet the commonsense standards shown in Box 1.

Box 1. Optimal Characteristics of Data Used for Eligibility Criteria

Subject to a relatively short lag-time, and updated frequently.
To avoid the problem of rewarding countries for successes five years ago – and failing to capture a current disaster-in-the-making – the data must be reasonably up-to-date.

Generally perceived as valid and reliable.
Data sources that have been used extensively in research study, and indicators that have been correlated to outcomes of interest, are far more desirable than brand new data sources that have had no external validation.

Available at a reasonable cost.
Criteria that require data to be generated anew through costly surveys or other collection exercises are likely to be seen as impractical, although a new data gathering exercise would be warranted for indicators that are seen as essential, but are simply unavailable through an existing database.

Accessible to non-governmental organizations and researchers in the U.S. and potential recipient countries.
This is the only means to achieve the transparency and clarity that will distinguish the MCA. It implies, for example, that all the elements of a composite index be available to the public.

Proposed Criteria

Below we summarize one set of criteria that would work well, and would meet the standards set forth for the data. We first set out the rationale for targeting countries as a function of their low income and poor access to borrowing, and then set out and discuss 12 criteria, using the three categories (ruling justly, economic freedom, and investing in people) that President Bush emphasized in his speech announcing the MCA initiative. Table 1 lists the criteria and provides some information on the probable number of countries that would likely be ineligible today due to each, out of the total number of countries for which the relevant information is available.

A Low-Income Threshold

We recommend that MCA funds, which will be available as grants, be targeted to countries that are very poor and that have limited, if any, access to private capital markets for sovereign borrowing. One simple approach is to target countries that are eligible for grants and loans from the "soft" or concessional IDA window of the World Bank (and of the other multilaterals including the IMF). For the most part, these IDA-eligible countries are the world's poorest, with income at or near no more than about $1000 per capita. There are a few large countries with that low a level of income that are able to borrow on private capital markets (as well as from the multilateral banks' hard windows), such as China and India; and there are a number of small island nations with higher income that are IDA-eligible because of their limited access to borrowing. Seventy-nine countries are currently IDA-eligible.[8] [9]

The IDA-eligible group is a natural starting point, but that should not imply outright prohibition of MCA funds going to other poor countries. On the one hand, many of the IDA-eligible countries likely to meet other standards for MCA eligibility already receive very high net transfers from donors. Some African countries receive 10 percent or more of their own GDP in transfers; Mongolia, Mozambique and Nicaragua receive more than 20 percent annually. On the other hand, since transfers often come in the form of multiple donor-driven projects, often financed by aid tied to donor supply of goods and services, it is possible that in countries performing well, much more could be absorbed effectively, particularly to finance recurrent costs (road maintenance, teacher salaries), or to provide budget support and debt reduction.[10] In addition, several of the larger IDA-eligible economies such as Bangladesh, India and Sri Lanka receive much less as a percent of their own GDP, so there is less of a question of absorbing new transfers should those countries be otherwise MCA-eligible.

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[8] This group includes countries whose income per capita is at or below $885 (2000 gross national income, Atlas method), most of whom are ineligible for borrowing from the World Bank's IBRD ("hard") window, plus 14 "blend" countries that can borrow from IDA and IBRD, plus the richer island nations referred to.
[9] Some of these 79 might be or become ineligible because U.S. legislation excludes them (as rogue nations for example.).
[10] See Birdsall and Williamson, 2002 and Steve Radelet's MCA note (September, 2002) "Beyond the Indicators" for more on absorptive capacity.

It is also true that many countries that are not IDA-eligible are still very poor (Ecuador, Egypt, Guatemala, Peru, the Philippines). Our recommendation is not that only IDA-eligible countries receive MCA funds, but that IDA eligibility, because it is based primarily on low income and limited access to private borrowing, is a natural starting point. MCA funds need not be limited to any single list of countries once and for all included or not. Rather, the MCA legislation should include a mandate for targeting countries as an inverse function of their income level and their ability to borrow. That implies thresholds of income and ability to borrow that are clear and pre-announced annually, but that can change over time.[11]

Ruling Justly: Criteria related to governance and respect for human rights

The challenge in this category is to capture *both* the governance-related characteristics that affect development aid effectiveness *and* the leadership characteristics and practices that indicate whether basic liberties and rights are respected. Fortunately, there are several useful datasets that can provide key information within this category.

Criterion 1. The judiciary is independent. Countries would be excluded if the judiciary were not independent of the political or administrative authorities, with judicial independence being characterized by such features as life tenure for appointed judges, irreducible salaries, and decisional independence. In countries where the judiciary is not independent, the remedies for curtailment of human rights and the rule of law by government authorities are greatly limited. Freedom House, a highly respected and independent NGO in the U.S., annually collects data about judicial independence (and many other conditions related to political rights and civil liberties) in 192 nations and 60 related and disputed territories through a standardized survey methodology.[12]The information on the independence of the judiciary is currently embedded in a composite index of civil liberties published by Freedom House. To be useful for the MCA, this single component (and the others mentioned in criterion that follow) of the composite index would have to made public. (Presumably the reluctance to publish the components of the two indices reflects uncertainty about the reliability of the measures of any one. Were this criterion to be adopted, we believe that the U.S. government and large private funders could and would be able to complement the Freedom House survey, to improve the reliability of these kinds of measures.

Criterion 2. A free press exists. Countries would be deemed ineligible if there does not exist a free and independent media and other forms of cultural expression. Freedom of the press is considered one of the most basic of civil liberties, and contributes in essential ways toward greater democratization. Again, Freedom House offers this variable within

[11] In any event, countries not eligible in a particular year for MCA funds would remain eligible for non-MCA U.S. aid programs; they would also have access to loans for development purposes from the multilateral institutions and in many cases some access to international private capital as well.

[12] Freedom House survey teams rely on a wide range of sources of information, including foreign and domestic news reports, NGO publications, academic analysis, and individual professional contacts. The survey work is supported by grants from the Bradley and Smith Richardson Foundations (www.freedomhouse.org).

its civil liberties checklist, but does not publish the indicator in disaggregated form. Though it would be difficult and controversial to rank countries on this measure, it should not be difficult to set and maintain a minimum standard, using other sources as well as the existing Freedom House surveys.

Criterion 3. Trade unions, peasant organizations or equivalents, and professional and other private organizations are permitted to exist freely. Freedom of association and respect the rights of civil society organizations is a fundamental characteristic of a society that has the potential for democratic practices. Countries would be excluded from the MCA if such organizations could not exist without heavy government intrusion. The Freedom House survey is the most promising current source of information on this indicator.

Criterion 4. The head of state and/or head of government or other chief authority is elected through free and fair elections. Self-evidently, a country in which presidential (or equivalent) elections do not take place in a reasonably free and fair manner is a long distance from democracy. Such countries would be out of the running for the MCA. The question of what is "free and fair" is not always simple; the Freedom House survey currently covers this question, and increasing attention at the international level suggests it would not be difficult to use this criterion to eliminate the most egregious cases (which, under our approach to "generous" criteria, would be sufficient).

Criterion 5. The head of state and/or head of government or other chief authority has been in power for less than 15 consecutive years.[13] Long leadership tenures are strongly associated with corrupt and anti-democratic practices. The threshold of 15 years would eliminate some of the worst offenders among the "President-for-life" leaders. There is no current multi-country database to which we could easily refer, but this information could easily be obtained and updated annually through USAID country offices and other country-specific sources.

Criterion 6. The national budget is transparent and publicly available (published regularly). Countries would be ineligible for the MCA if they did not provide their citizenry (or the donor community) with a clear accounting of public expenditures, on a timely basis. This practice is central to good governance, and demonstrates at least a minimal degree of responsiveness to civil society. This information would be available through USAID country desks, as well as through the World Bank country departments.

Criterion 7. Public administration is relatively free of corruption. The extent of corruption is a key determinant of how well aid will be used, and how well the public sector functions in general. The best source of data for this is the World Bank Governance Index, although suggesting its use represents an exception to our guidelines calling for single-indicators and for absolute measures, with the following rationale: Virtually all corruption ratings are composites, given that they represent a wide range of practices and actors. In addition, recognizing that no country is ever free of corruption, it

[13] Were the judgments under criterion 4 straightforward and impervious to controversy, then criterion 5 would, we recognize, be redundant.

is more practical (and politically sensible) to think of relative "goodness" and "badness" in this dimension.

Economic Freedom: Criteria related to policies that promote or hinder economic growth

There is much disagreement about the utility of traditional World Bank/International Monetary Fund indicators of openness to trade and other policies that might be put into the "economic freedom" basket, and the MCA designers would be well advised to steer clear of these debates. However, it is possible to identify a small number of macroeconomic indicators that are indisputably linked to the potential for economic growth in the short- and medium-term.

Criterion 8. The three-year moving average for inflation is less than 20%. Relatively low inflation reflects satisfactory macroeconomic management, and is closely tied to the behavior of and prospects for both investors and consumers. High inflation is particularly costly for the poor. Analyses suggest that once inflation reaches levels close to 20%, moreover, it tends to accelerate to even higher rates, unless and until drastic measures are imposed that are costly in lost growth. Thus, a country would be deemed ineligible for the MCA under conditions of very high inflation. This information is available through the World Bank's *World Development Indicators* among other sources.

Criterion 9[14]. The average weighted tariff rate does not exceed 35 percent; barriers to capital imports are not too great. The objective of this indicator is to eliminate countries where government policy reduces competition by closing the economy; too great a reduction of competition is usually associated with local industrial, agricultural and other special interest group pressures. The most obvious form such pressures can take is that of high import tariff rates. Import protection hurts small businesses the most, because they are unable to import the inputs needed for their production or services; larger businesses with insider access avoid the problem and in effect retain local producer monopolies. Protection also raises prices for poor consumers, and along with export subsidies, is likely to reduce job creation, especially for the less-skilled workers.

But tariff rates are an imperfect measure, to say the least, of trade protection and of anti-competitive policies more generally. Protection also comes in the form of non-tariff barriers of all kinds, and of local producer and export subsidies.[15] These are difficult to measure, and some of these, such as delays and demands for bribes at the border, may reflect general institutional problems as much as or more than any explicit "policy" of protection. Nor can we resort to existing much-used and well-known

[14] Our goal was to identify a robust measure of trade policy. After reviewing many options, we found that all of the standard indicators of 'openness' fail to adequately target the components of openness that influence growth and poverty reduction. For analysis of the shortcomings of various indicators of "openness" see Rodriguez and Rodrik (2000).

[15] An unfortunate but obvious example are the subsidies to agriculture in Europe, Japan and the United States. The hypocrisy inherent in the U.S. setting a higher standard for the poorest countries than in its able to manage politically itself should, however, not be an argument for skipping that standard in the MCA, but for eliminating the distortion in the U.S. In fact the U.S. Trade Representative has announced a goal of eliminating all U.S. agriculture subsidies by the year 2005.

measures of "openness",[16] as they usually measure a range of factors that may actually reflect success or failure of a country in global markets, independent of policy effort, and which are correlated with but as likely to reflect as to be causally related to economic growth.[17]

If the goal is to measure the aspects of trade policy most likely to lead to job-creating growth, barriers to imports of capital and intermediate goods that support the production of manufactured items for export is probably the best single measure. However, in the absence of that information in the short run, setting a (very low) threshold of 35 percent import tariffs has the benefit of simplicity and clarity.

<u>Criterion 10. Regulation on business is not overly burdensome</u>. An indicator that separates countries in which the governments are hostile to private investment, and particularly the development of small and medium-sized enterprises, is needed to ensure that as the public sector is supported in fulfilling its key role, the private sector has the opportunity to create the jobs and wealth that are a sine qua non of economic growth. At the moment, the best indicator available appears to be through the composite Regulatory Quality index from the World Bank. A cutoff of –1 could be applied to rule out the most business-unfriendly regulatory regimes. However, it would be desirable to identify a simpler indicator, if a data source with good country coverage could be developed.

<u>Investing in People: Criteria related to human development and government's fulfillment of core responsibilities</u>

The central challenge in this category is identifying indicators that reflect relatively recent policy developments; that are robust to donor behavior (such as waxing and waning interest of donors in primary health care); and that are connected not only to social sector spending but also to good human development outcomes.

<u>Criterion 11. DTP3 coverage is greater than 50%</u>. A country would be ineligible for the MCA if it failed to achieve the relatively unambitious target of 50% DTP3 coverage. This indicator is chosen because it can change over a relatively short period of time in response to improved (or worsened) financing and organization of the basic health system; and because a government that fails to achieve at least this level of childhood immunization coverage is manifestly neglecting one of its core responsibilities. The World Health Organization provides these figures on a routine basis for virtually every country in the world

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[16] Sachs and Warner, 1996(?); Dollar and Kraay, 2001.

[17] Birdsall and Hamoudi (2002), for example, demonstrate that many very open poor countries that are heavily dependent on primary commodities for their exports, would not be counted as "open" or as globalizers.

[18] An unfortunate but obvious example are the subsidies to agriculture in Europe, Japan and the United States. The hypocrisy inherent in the U.S. setting a higher standard for the poorest countries than in its able to manage politically itself should, however, not be an argument for skipping that standard in the MCA, but for eliminating the distortion in the U.S. In fact the U.S. Trade Representative has announced a goal of eliminating all U.S. agriculture subsidies by the year 2005.

Criterion 12. Non-salary spending on basic education per school aged child amounts to some minimum percentage of total of government revenue – probably about 10 percent. This criterion attempts to capture whether the government is devoting at least a minimal amount to basic education – one of the public sector's core responsibilities, and one that is closely linked to medium- and long-term development prospects. The emphasis is on non-salary spending for two reasons: First, in most developing countries, availability of educational inputs other than teachers, such as textbooks and supplies, severely limits the quality of basic education. Second, salary-related spending is strongly affected by civil service laws and the relationship between the government and teachers' unions – both of which are likely to reflect long historical tendencies, rather than recent policy decisions. Data on total government spending on education as a share of government revenue are available from the World Bank's *World Development Indicators* and spending on basic education can be estimated from that source. Specific country-level studies of education spending also are available through the World Bank, UNESCO, USAID and other sources. The number of school-age children can be easily derived from demographic data available through the U.S. Census Bureau.

Eligible Countries

We applied these criteria (or the closest reasonable proxies, in the cases where the information was not available to us) to the 79 countries that are IDA-eligible. (Notes on our data sources appear in Appendix C.)

Table 1 shows the number of countries among the 79 eliminated by the various criteria, and for each criterion the number of countries for which we had some information to apply. We gave countries the benefit of the doubt in cases of missing data, i.e. we assumed they did meet the respective criteria. Almost half of the 79 were eliminated by the composite indices of civil and political liberties of Freedom House[19]. Many fewer countries were eliminated by the criteria related to economic freedom and investing in people. That may be due to the information in those categories being less complete, or due to our setting the thresholds for meeting these criteria lower (in some relative sense) than were the thresholds for the governance indicators.[20]

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[19] In the absence of individual indicators for the governance criteria, we relied on the Freedom House Indices of Civil Liberties and Political Freedom which contain the governance criteria we name. All countries scoring 5 or higher on these indices were eliminated; a rating of 5 indicates that a country is likely to have experienced phenomena like civil war, heavy military involvement in politics, or unfair elections. If we relax the criteria to include countries that rank five, only three others are included: Uganda, Albania and Liberia.

[20] The thresholds set will indirectly constitute weights on the different components, as Steve Radelet has pointed out. That is another argument for using generous thresholds; perhaps our threshold on the governance indicators was not sufficiently generous, as we note below.

The result of the exercise leaves only 26 countries still eligible. Of those 26, seven are small island nations with income well over $1000 per capita. The remaining 19 include Bangladesh[21], Bolivia, Ghana, Honduras, Mongolia, Mozambique, and Senegal. (Uganda, hailed as a recent development "success story," is not included on this list. While it did meet the economic and social standards, it did not cross the governance threshold. If we relax the political freedom and civil liberties standards from a maximum bad score of 4 to a maximum of 5 in the Freedom House scoring, Uganda, Albania and Liberia would be included.)

As we remarked above, some of the IDA-eligible countries with already high net transfers from abroad may not necessarily receive aid in a form that is conducive to their effective use. Still, it may make sense to include other poor countries for the MCA. Of countries with income per capita above the IDA-eligibility limit (of about $1000 per capita), there are 11 (of 26) countries, including Guatemala, the Philippines, and Romania with GDP per capita of $2000 or less that meet the governance criteria, and another 12 (of 14) including Jamaica and the Dominican Republic with GDP per capita income less than $3000. [22]

Because our data are incomplete, and because we used composite indices as proxies, we elected not to publish the resulting list of "eligible" countries, beyond citing the examples above, on the grounds that the list could be misleading and would almost surely distract readers from our basic message – linking the objectives of the MCA to a limited list of easily understood and relatively "generous" eligibility criteria, and relying on a second competitive stage of country-owned proposals as the basis for final annual grantmaking decisions.

**Table 1. Summary of Criteria
and Number of Countries Ineligible for MCA if Criteria Were Applied**

Criterion	Number of Countries Excluded (of 79 IDA-eligible countries for which data were found)
1. The judiciary is independent	38 (of 79) (Using Freedom House Indices)
2. A free press exists	
3. Trade unions, peasant organizations or equivalents, and professional and other private organizations are permitted to exist freely.	

[21] Transparency International's 2001 Corruption Perceptions Index ranks Bangladesh as worst among 91 countries. They do say that data for Bangladesh in 2001 was "available from only three independent survey sources, and each of these yielded very different results. While the composite score is 0.4, the range of individual survey results is from -1.7 to +3.8. This is a greater range than for any other country. TI stresses, therefore, that this result needs to be viewed with caution." The data we use deems Bangladesh eligible, but TI clearly identifies weaknesses in the country's governance. This reality of uncertainty and difference in judgments argues for generous initial thresholds so as to not exclude a country wrongly. The danger of including countries wrongly is mitigated by the fact that closer scrutiny can be given during the competitive second phase of country selection.

[22] Egypt (under $2000), Tunisia, and Peru (under $3000) are among those that would be excluded using the Freedom House indices of political and civil liberties.

4. The head of state and/or head of government or other chief authority is elected through free and fair elections.	
5. The head of state and/or head of government or other chief authority has been in power for less than 15 consecutive years.	At least 10 countries (information incomplete)
6. The national budget is transparent and publicly available.	The information probably exists but is not compiled in an accessible form
7. Public administration is relatively free of corruption	16 (of 60)
8. The three-year moving average for inflation is less than 20%.	10 (of 60)
9. Weighted average tariff rate less than 35%.	2 (of 34)
10. Regulation on business is not overly burdensome	5 (of 65)
12. DTP3 coverage is greater than 50%.	19 (of 63)
12. Non-salary spending on basic education per school aged child amounts to 9% of government revenue	3 (of 36)

Acknowledgements. This note is based on wide-ranging discussions with persons inside and outside the U.S. Government on the design of the Millennium Challenge Account, as well as our experience and analysis of past problems in development assistance policies and implementation. We are grateful to the many specialists from the Executive Branch, Congress, the NGO community, the research community, and the international financial institutions who participated in five workshops organized by the Center for Global Development in Washington, and to Minister Hilde Johnson of Norway, staff of the Carter Center and InterAction, and officials and non-governmental organization leaders from Africa and Latin America who participated in a CGD workshop in Monterrey, Mexico, at the time of the United Nations Conference on Financing for Development. We especially thank George Soros, Jeff Sachs, Jennifer Windsor and Daniel Kaufmann for their presentations at the CGD workshops. We also thank George Soros and the participants in a workshop he organized of the Open Society Institutes in Africa, held in Johannesburg, South Africa in May, 2002, in which Sonal Shah participated. Finally, we are grateful to CGD colleagues for discussion and their comments. We see this note as one contribution to a continuing discussion, which will be extended at CGD through the work of Steve Radelet.

Appendix A. Guiding Principles for the Design and Implementation of the Millennium Challenge Account

Nancy Birdsall, Sarah Lucas, Sonal Shah*

In the run-up to the March 2002 UN Conference on Financing for Development in Monterrey, Mexico, President Bush announced a new compact for development, proposing an additional $10 billion in foreign assistance over fiscal years 2004 – 2006, to ramp up to an annual aid level of $5 billion above current amounts. This new money would be channeled through a "Millennium Challenge Account" (MCA) and would be targeted towards countries already walking the hard path of development-friendly reforms – countries that demonstrate adequate performance along three dimensions: good governance (ruling justly), economic freedom (fostering entrepreneurship), and investment in people (education and health). In his speech announcing the proposed increase in U.S foreign aid, the President called on U.S. policy makers to engage with each other and with the international community to define a set of clear and objective selection criteria to determine country eligibility for MCA resources.

This note defines seven principles to guide the design and implementation of the MCA. It builds on two assumptions: that MCA resources will be targeted to low-income countries (e.g. all those that are IDA-eligible) that have limited, if any, access to private capital markets for sovereign debt, and for whom borrowing from the World Bank and other multilaterals is limited; and that the MCA will be an additional program to those already financed and administered by the U.S. Government, which have related but not identical objectives, and affect a set of countries that is not necessarily the same.

The appendix sets out one example of how to make these principles operational.

1. Ring-fence the MCA for development

MCA resources should be ring-fenced solely for development and used where they will be most effective in fostering development. In the interest of increasing overall aid effectiveness, the design and administration of the MCA should allow for flexibility

* Respectively President, Program Associate, and Director of Programs and Operations, Center for Global Development. This note is based on wide-ranging discussions with persons inside and outside the U.S. Government on the design and implementation of the Millennium Challenge Account, as well as on our experience and analysis of past problems in development assistance policies and implementation. We are grateful to the many specialists from the executive branch, Congress, the NGO community, the research community, and the international financial institutions who participated in two workshops on the MCA organized by the Center for Global Development in Washington, and to Minister Hilde Johnson of Norway, staff of the Carter Center and InterAction, and officials and non-government organization leaders from Africa and Latin America who participated in a CGD workshop in Monterrey, Mexico, at the time of the United Nations Conference on Financing for Development. We especially thank George Soros and Jeffrey Sachs, who set out their own ideas and proposals at two of the workshops in Washington. We also thank George Soros and the participants in a workshop he organized of the Open Society Institutes of Africa in Johannesburg in April, 2002, in which Sonal Shah participated. Finally, we are grateful to our CGD colleagues for discussion and their comments, especially Ruth Levine. We see this note as one contribution to what is likely to be a continuing discussion.

and provide for the opportunity to learn and adapt the design over time. In doing so, the United States would take renewed leadership in the shaping of the international aid architecture, taking into account lessons learned from the past.

2. Focus on strengthening national institutions

One MCA objective is to support good and honest governments by helping them to gain the national capacity to build and maintain strong and stable institutions. To this end, the MCA should fund programs that are endorsed by and channeled through eligible national governments. These programs could take several forms. They could be national government initiatives, programs that are financed in the government budget but are partially or entirely managed by accredited civil society groups, or in some cases it is possible to imagine that the government would sponsor or endorse a major proposal from a national NGO.[*]

To create incentives for policy change, the minimum standards for country eligibility for the MCA should be simple, transparent, and publicly announced. This would also permit Congress and U.S. citizens, as well as citizens, civil society groups and policy makers within poor countries, to understand and monitor eligibility-related policies at the country level.

3. Build in an easy exit mechanism for donors

The history of foreign aid suggests several factors have made it difficult for donors to exit countries where policy or performance was deteriorating, contributing to claims that aid has been ineffective (e.g. Indonesia in the early 1990s, with increasing levels of corruption; Kenya throughout the 1990s, given repeated fresh efforts of reformist ministers). One factor has been the ambiguity about what degree of performance constitutes success, and what standards of governance and economic policy constitute an adequate environment for success to occur. Another has been an understandable tendency to be hopeful and helpful, despite indications that a government is faltering, because certain officials continue to exhibit good will and make fervent promises to fulfill their own commitments. The MCA would ideally build into its design an approach that creates a relatively automatic exit point, while making it possible but far from predictable that a country would re-enter the MCA with a 'new' program at a later time.

4. Foster recipient country ownership

The evidence shows that foreign aid is most effective when it supports development strategies, policies and programs that are designed and implemented by leadership in the country receiving the aid, and politically supported and thus sustained

[*] The MCA should be additional to existing US foreign assistance, some of which will no doubt continue to be channeled directly to NGOs and civil society groups. These resources will be especially critical for the many countries that do not meet the MCA criteria, or do not receive MCA funds in a given period.

by that country's citizens and business and political communities. The MCA should be designed to reinforce this principle, by supporting country-based programs such as the World Bank Poverty Reduction Strategy Paper (PRSP) process, which build in country-designed development strategies, performance benchmarks, and accountability mechanisms.

5. Encourage competition

Though country eligibility should be simple and transparent, the selection of funded programs should be competitive in nature, perhaps based on an annual 'contest' for fixed-term grants. A competitive system promotes ownership since it requires that governments set priorities and propose programs to be funded, including their own goals and measurement benchmarks. This allows for the use of the countries' proposed benchmarks in judging the proposals and in measuring performance during the grant period. Successful programs can have continuity, but the U.S. would have the option for automatic exit after a fixed period so it need not renew programs that are not working, nor any programs in countries that have become ineligible. Finally, such a system lays the groundwork for healthy competition among U.S. agencies and helps define an approach that could ultimately be imitated to create a larger competition among donors.

6. Insist on full public disclosure

To ensure transparency, we recommend that all relevant decisions and documents be made publicly available, allowing all parties, including local NGOs and media, to have access to information and hold national governments and the relevant US agencies accountable for their decisions and commitments.

7. Complement existing frameworks

Design and implementation of the MCA would ideally build on and complement internationally endorsed existing frameworks such as the national strategies for meeting the Millennium Development Goals and the PRSP process, and whenever possible be consistent with such regional efforts as the African leaders' New Partnership for African Development. At the same time it makes little sense for the MCA to be constrained in taking a different approach by existing bureaucratic or political arrangements that are not practical or do not reflect the specific objectives of the MCA itself.

Appendix

Millennium Challenge Account

One Approach For Design and Implementation*

Based on the seven principles laid out previously, we set out here an example of one possible approach for the design and implementation of the Millennium Challenge Account. We suggest a **two-step process** which builds in **selectivity** (country eligibility); includes healthy **competition** among countries and programs; fosters greater **ownership** of programs on the part of recipient countries; and provides the US with a clear and objective point at which to **exit** an aid relationship with a given country.

The selection process would be repeated periodically, probably annually, and would include the following two steps:

> *Step 1. Identify eligible countries based on their meeting a minimum threshold of eligibility, using simple and clear standards.* This step is binary in nature – a country falls in one of two categories, eligible or not.
>
> *Step 2. Invite eligible countries to participate in a competitive process to receive 2-3 year grants.* Selection in this step is not 'all or nothing', but could include a continuum of support based on the technical quality of proposals.

Step 1: Country Eligibility

We assume that the MCA would be used only for those countries that are low-income and have limited access to other resources, such as the 79 IDA-eligible countries. The initial eligibility standards applied to these countries would reflect President Bush's three priority areas: ruling justly, economic freedom, and investing in people. Standards would not explicitly rank countries, but would simply indicate which to include in (or exclude from) a competition for program support in step two.

The eligibility standards are minimums, below which countries are simply not eligible. They are not likely in themselves to provide appropriate indicators of progress of specific programs, or even of an overall country program (except in the case of a country switching from above or below the minimum threshold.) They define goals for future policy change, but are not indicators or benchmarks for good outcomes.

* This example of an approach for the MCA represents our initial response to the MCA, and is based on a series of CGD-hosted policy discussions and our previous experience and analysis of aid delivery mechanisms, conditionality and selectivity, and lessons learned from past aid policies. The Center for Global Development is conducting research on issues related to aid delivery and effectiveness. This entails a number of studies including a comprehensive look at aid effectiveness and alternative delivery mechanisms, led by William Easterly; and an analysis and set of recommendations for US policy towards "Poorly Performing States" led by Robert Ayres. Building on these studies, Steve Radelet will lead CGD's analysis and recommendations on the design and implementation of the MCA.

Following are several examples of conditions that could exclude a country from eligibility.

- With regards to ruling justly: inadequate press freedom; government budgets that are not available for public scrutiny; jailing of political opposition leaders; evidence of fraudulent elections; lack of an independent judiciary; and evidence of high-level corruption (including via information on capital flight).
- Regarding economic freedom: official violations of property rights; inability to enforce contracts; onerous regulatory or tax burden on medium-size enterprises; presence of price controls or high levels of inflation.
- Regarding investing in people: failure to spend more than some specific percent of government revenues on basic health and education, combined with failure to increase spending in those sectors in last 5 years; lack of a comprehensive national health strategy or strategy for HIV/AIDS.

Country eligibility would be announced periodically, e.g. annually. This would create incentives for relatively poor countries' leaders to move in certain directions, and for their citizens to create pressure for such movement. This would also allow for the inevitable movement of countries in and out of eligibility without locking donors into fixed commitments in deteriorating settings. Programs once funded (e.g. for two or three years) would not be cut off if a country loses eligibility, but could not be renewed for a new period. (The US could legitimately change the nature of the eligibility standards based on lessons learned and subject to full public disclosure; full disclosure would encourage development advocates to monitor the choices and recommendations of both public agencies involved in the process and private interests with particular country and commercial concerns.)

Step 2: Competitive Program Selection[*]

Each year, countries deemed eligible would be invited to participate in a competition for twp to three year grants from the MCA. Proposals from eligible governments would be reviewed by a technical review board (or boards), which would rank all acceptable proposals and submit its rankings to the appropriate decision-making agency of the United States Government.

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[*] The "contest" approach is used by the Gates Foundation and many other independent U.S.-based foundations for specific programs, and by the country-based Open Society Institutes financed by George Soros. Probably the most ambitious use to date at the level of funding by official donors contemplated under the MCA is The Global Fund to Fight AIDS, Tuberculosis and Malaria, which has just completed its first cycle of awards. No doubt it is worth assessing carefully its relevance for use in an even larger program. Though the World Bank and USAID do make grants or loans on the basis of proposals, countries are not clearly competing with each other in a specific time period for limited funds. The competition, to the extent it exists, is much less transparent, and is often driven by a pressure to lend or make grants.

Country proposals could take several forms, ranging from budget support for a country's entire growth or poverty reduction strategy (as already embodied for example in a PRSP) to sector-wide programs in health, education, judicial reform, or a major sub-sector program (HIV/AIDS prevention, small business development support, university reform). Proposals could include support for a scale-up of existing successful programs, justified by evidence that the approach represents best practice, or for new and innovative development programs.

Technical Advisory Board(s)

Proposals would be assessed by one or more technical advisory boards. The country proposals and the reviews of the technical advisory boards would be available to the public (perhaps posted on a central website), including the overall recommendation of acceptability or not; the ranking, however, would not be publicly disclosed. This would foster transparency and accountability at all stages of the process: accountability of donors to the principles of the MCA in the selection process; of the recipient governments to their citizens in the implementation of the funded programs; and of recipient countries to donors and national citizens in achieving development goals. The actual decision on awards in each cycle would rest with the relevant agency of the U.S. Government.

Inherent Trade-Offs

The choice of criteria for country eligibility, including both the indicators themselves and the threshold levels for those indicators, implies three types of trade-offs: fairness vs. flexibility; simplicity vs. nuance; and inclusion vs. exclusion. These trade-offs are outlined below, along with our recommendations. We emphasize that the establishment of the criteria is a principal way in which the MCA is distinguished from other forms of aid delivery, and the criteria can (and should) be subject to evaluation and modification as the MCA evolves.

- First, there is a trade-off between the **"fairness"** of a rules-based system, in which strict and explicit criteria are applied across all countries with no deviation, on the one hand, and the **flexibility** to respond to unique and dynamic country conditions with a fully discretionary approach, on the other. Although both approaches involve politics and negotiation, the rules-based system restricts political influence to the establishment of criteria, whereas the discretionary approach is subject to political forces all the way up to the moment of determining country eligibility. ***To achieve the aims of the MCA, we recommend a system that is significantly more transparent than current aid mechanisms, and that sends clear signals to countries regarding what is required to achieve and maintain eligibility for funding – that is, a primarily rules-based approach, using a combination of qualitative and quantitative criteria.*** In the first stage of the funding decision, a clear "yes/no" decision about which countries meet a minimum threshold for consideration, based on straightforward criteria, permits a healthy competitive process among program proposals during a second stage. In that second stage, programs can be compared on the basis of technical soundness, without the confounding factor of the overall country environment.

- Second, there is a trade-off between the **simplicity** of applying a small number of indicators that are clearly defined and reasonably measurable, and the **ability to make fine distinctions** that would be possible with a larger number of highly nuanced indicators. For example, the selection of "gross primary school enrollment rate" as an indicator for "investing in people" might have the advantage of being relatively simple and measurable, but might not capture the concept of "investing in people" as well as a combination of more complex measures of teacher preparation, school quality and gender balance in education. In deciding among these options, it is useful to remember that combining multiple measures in a meaningful way to arrive at binary ("yes/no") decisions about country eligibility is complex, and invites lobbying among various interest groups about which criteria should be weighed more or less heavily in the final decision. ***To meet the aims of the MCA, we recommend that the indicators be restricted to a very small number (a handful or fewer) that correspond well to widely accepted indicators; and that clear decision rules be established ex ante.*** We also recommend that a country would have to fully meet all the criteria in each area (ruling justly, economic freedom and investing in people) to be deemed eligible.

- Third, there is a tradeoff between establishing very demanding thresholds for the indicators, which will lead to the **exclusion of a large number of countries**, and establishing more generous thresholds that will lead to **the inclusion of a large number of countries**. For example, if countries must demonstrate very high levels of achievement in the areas of ruling justly, economic freedom and investing in people, then it is likely that a very small number of the IDA-eligible countries would qualify. If, however, the thresholds are less strict, a correspondingly broader number of countries would be eligible for the competition for funding of their programs. The question of whether to go for broad or narrow eligibility is related to two issues: First is the extent to which the MCA seeks to learn through funding programs in a variety of social, political and economic contexts. If a relatively diverse experience is desired, this implies more generous eligibility criteria. Second is the practical question of managing the second-stage review process for the detailed proposals for funding. It is likely that review of a large number of proposals will be slow and cumbersome, and defeat the MCA intention of being a streamlined mechanism for aid delivery. On the other hand, too-narrow country eligibility could undermine the value of competition at the program selection stage. In practice, it is likely that setting the precise thresholds for quantitative criteria will involve some empirical testing to see how many countries are included or excluded at different threshold levels. ***On balance, we recommend that the criteria be established at a threshold levels that***

permit some variation in country characteristics among the eligible set, but keep the total number of eligible countries well within a manageable number.

The complexities of choosing criteria for country eligibility may seem daunting, but the advantage of using these criteria as part of a clean two-stage process are substantial. The first stage – a "yes/no" determination of country eligibility – can be used to send unambiguous signals to countries about what the U.S. is looking for in a development partner. The second stage – competition among programs across eligible countries – can then allocate funds based on the probability and size of the positive development impact of proposed programs, as judged by a thorough and well-informed technical review.

Ensuring and Evaluating Effectiveness

The MCA provides a unique opportunity for the US to turn the tide of the aid effectiveness debate. Our example increases the likelihood of effectiveness by recommending that the MCA be used exclusively for development purposes, by fostering ownership, and by providing for an easy exit decision. This example offers a new approach to evaluation by having applicant countries design their own measurement benchmarks and accountability mechanisms, and incorporate them into their program proposals. Proposals would be judged partially on the strength and feasibility of the benchmarks and evaluation measures. USAID or another relevant agency would work closely with recipient countries in monitoring progress (and disbursing funds), and ensuring that funds are used as intended. To ensure that the MCA is being implemented in line with its own principles, and is effective in meeting its goals, the GAO or another independent auditing agency could conduct an independent review of the account every two years.

Appendix B. Comments by Members of the Administration on the Objectives of the Millennium Challenge Account

Today, I call for a new compact for development, defined by a new accountability for both rich and poor nations alike. . . The goal is to provide people in developing nations the tools they need to seize the opportunities of the global economy.

President George W. Bush
Inter-American Development Bank
March 14, 2002

The President said that the United States supports the international development goals that are expressed in the millennium declaration, and stresses the importance of focusing on development outcomes.

Alan Larson,
Under Secretary of State for Economic, Business and Agricultural Affairs
Briefing on International Conference on Financing for Development
March 15, 2002

The President's new approach to development gives us an opportunity to show real results for the investment our taxpayers make in foreign assistance. By directing funds from the MCA to countries with a good policy environment, there is greater chance that the funds will be used effectively to promote productivity and growth and reduce poverty.

Paul O'Neill, U.S. Treasury Secretary
Testimony before the House Appropriations Subcommittee on Foreign Operations
April 24, 2002

Official development assistance . . . stands a better chance of success when local leaders are already improving the economic framework of the nation. That is the premise of the President's Millennium Challenge Account.

Paul O'Neill, U.S. Treasury Secretary
Makerere University, Kampala, Uganda
May 28, 2002

President Bush has assigned Secretary O'Neill and Secretary Powell the task of developing the objective criteria for measuring countries' policies in these areas, and we are hard at work on this task now. We are using empirical research on economic growth over the last 10 years and performing our own research. We place a premium on simplicity and robustness. We want something that can be easily understood.

John Taylor
Under Secretary of the Treasury for International Affairs
April 30, 2002

We are looking to create competitions among countries for our development dollars. The new resources the MCA will make available will be a powerful incentive to encourage them. We expect that only a relatively small number of countries will be selected for MCA funding at the beginning, so those that do can expect a substantial reward. In the meantime, we are refashioning our mandate in USAID for non-MCA countries, to focus on helping these nations qualify for MCA at some point in the future.

Andrew Natsios
USAID Administrator
June 5, 2002

Fact Sheet, June 3, 2002

MCA Guiding Principles for fund distribution:

- Country selection will be keyed to potential for economic growth and poverty reduction.
- Funds will be distributed in the form of grants. Where appropriate, programs funded by this account will be coordinated with ongoing programs and leverage other funding streams, both from within the recipient country and from other private, bilateral and multilateral donors.
- Qualifying countries will be encouraged to actively engage with us in formulating uses for MCA funding through a participatory process involving local and federal elected officials, civil society, and development partners.
- The development priorities, investment needs, and growth potential of selected countries will determine how funds are allotted.
- Where possible, the MCA will seek to broaden development partnerships by including new partners, such as private sector firms, national and local governments, U.S. and local universities, foundations, and international and local NGOs.
- Building capacity for quality data development and continuous country and project performance monitoring will be important components of the MCA and will be incorporated into its implementation.

Uses of the Millennium Challenge Account, June 19, 2002

- The goal of the MCA program is to promote economic growth and poverty reduction in developing nations that have made a strong commitment to ruling justly, investing in people, and promoting economic freedom.
- The combination of MCA assistance and private capital flows will help these countries achieve sustained high rates of economic growth, continue to improve accountable governance, and provide a better standard of living for their people.
- The MCA will help countries that have made this commitment to further increase trade, investment and private capital flows to their economies. If the MCA is successful, these countries will becoming fully creditworthy and serve as exemplars for other developing nations.
- The MCA will prioritize investments in these sectors:
    - Trade and Foreign Investment

- Agriculture and Conservation
- Just Governance
- Health
- Education and Human Capacity
- Information Technology
- Private Enterprise and Entrepreneurship
- Data collection and Measurement Capacity

Appendix C. Data Sources for Illustrative Application of Criteria

Criteria 1, 2 and 3. Independent judiciary, free press and freedom of association. Because disaggregated indicators from Freedom House International are not yet available, for each of these three criteria all countries scoring 5 or higher on Freedom House's publicly available "civil liberties index" (http://www.freedomhouse.org) were disqualified.

Criterion 4. Free and fair elections. Because disaggregated indicators from Freedom House International are not yet available, all countries scoring 5 or higher on Freedom House's publicly available "political freedom index" were disqualified.

Criterion 5. Length of term of political leadership. No data have been found for this criterion.

Criterion 6. Transparent budget. No data have been found for this criterion.

Criterion 7. Control of corruption. Scores are taken from the KKZ 2001 dataset (http://www.worldbank.org/wbi/governance/datasets.htm). Countries which scored below -1 in "control of corruption" were disqualified.

Criterion 8. Inflation rate. The annual change in consumer prices over the period 1998-2000 was taken from the World Bank's *World Development Indicators 2001*, (http://www.worldbank.org/data/wdi2002/index.htm), and a linear average calculated. (In a few cases were year 2000 data were not available, the period 1997-1999 was used instead.) If the linear average was greater than 20%, the country was disqualified.

Criterion 9. Tariff Rate. Unweighted average tariff rates are taken from appendix table A.2 (page 568) of *Development, Trade, and the WTO* (World Bank). The year varies by country—in most cases, it is not earlier than 1996 or later than 1999. If the unweighted average tariff rate was greater than 35%, a country was disqualified.

Criterion 10. Regulatory burden. The "regulatory quality" scores are taken from the KKZ 2001 dataset (http://www.worldbank.org/wbi/governance/govdata2001.htm). Countries which scored below -1.5 in "regulatory quality" were disqualified.

Criterion 11. Immunization coverage. Rates of coverage during the year 1999 with all three courses of the standard Diphtheria, Pertussis, and Tetanus combination vaccine (DPT3) were taken from the World Bank's *World Development Indicators*, and are also available from the World Health Organization http://www-nt.who.int/vaccines/GlobalSummary/Immunization/CountryProfileSelect.cfm
In the few cases where year 2000 data were available, these were used instead. If the coverage was 50% or below, a country was disqualified.

Criterion 12. Education spending. Data on total government spending on education as a share of government revenue were taken from the World Bank's *World Development Indicators*. Data refer to the year 2000—or, in a few cases where year 2000 data were not available, the year 1999. If school aged children account for only a third or so of the population in most IDA-eligible countries, this would mean that the sum of all non-salary spending on basic education per capita should amount to 3% of government revenue. If 10%-15% of **total** educational spending is for non-salary inputs in primary or secondary education, this would mean that in order to meet the criterion, a total of 25%-30% of government revenue should be devoted to educational spending (salary and non-salary). Therefore, countries in which total spending on education amounted to less than 30% of government revenue were disqualified. The number of school-age children can be easily derived from demographic data available through the U.S. Census Bureau. (http://www.census.gov/ipc/www/idbnew.html).

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