Center for Global Development

MCC at 10: Focus on Policy Performance
MCC's Model in Practice

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MCC at 10 Series

The Millennium Challenge Corporation (MCC) is now ten years old. It was established with bipartisan support as an independent US government agency in January 2004. Though MCC has always been a relatively small agency (less than five percent of the US government's foreign aid spending), it was, from the outset, created to deliver aid differently, with both mission and method reflecting generally accepted fundamental principles of aid effectiveness.[1]

MCC's sole objective is to reduce poverty through economic growth, with three key pillars that frame how it pursues that goal:

1) **Policies matter:** MCC partners only with countries that demonstrate commitment to good governance on the premise that aid should reinforce and reward those countries with policies that are conducive to growth-promoting private sector activity and investment.
2) **Results matter:** MCC seeks to increase the effectiveness of aid by identifying cost-effective projects, tracking their progress, and measuring their impact.
3) **Country ownership matters:** MCC works in partnership with eligible countries to develop and implement an aid program on the premise that investments are more likely to be effective and sustained if they reflect the country's own priorities and strengthen the partner country government's accountability to its citizens.

Taking stock of MCC's first ten years and with a view toward the future, this series of MCC Monitor Analyses addresses three main questions for each of the three pillars of MCC's model:

- To what extent has MCC's model governed its operations in practice?
- How should MCC strengthen and expand its model and operations over the next ten years?
- With other USG development agencies adopting many of the aid effectiveness principles that underpin MCC's model, how is MCC still different that other modes of US foreign assistance?

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[1] According to US Overseas Loans and Grants (http://gbk.eads.usaidallnet.gov/data/fast-facts.html), MCC was responsible for just under five percent of US economic assistance disbursements in FY2012. In comparison, USAID was responsible for 35% and the State Department 38%. The George W. Bush administration's original vision of MCC was that it would have an annual budget of $5 billion rather than the approximately $1 billion it has received each year. Even if it had reached the higher level, it still would have been only around half the size of both USAID's and the State Department's annual foreign assistance obligations each year.

Focus on Policy Performance: MCC's Model in Practice

Introduction

A key pillar of MCC's model is its focus on policy performance. One of MCC's defining characteristics is that it provides funding only to countries that demonstrate commitment to good governance and growth-friendly policies. In its first ten years, MCC has targeted more of its funds toward relatively well-governed countries than almost any other donor worldwide, and certainly more than any other US government agency providing foreign assistance.[2]

There are three main aspects of how MCC takes policy performance into account in its determination of partner countries:

1. Selecting countries for compact or threshold program eligibility;[3]
2. Suspending, terminating, or otherwise curtailing eligibility and/or program funding;
3. Funding targeted policy reform activities through the threshold program.

This paper looks at how well MCC's employment of each of these approaches has supported, in practice, the agency's core operating principle that policies matter. It explores how MCC remains different from other US foreign aid thinking and practice around aid targeting based on policy performance, and it offers recommendations for how MCC should strengthen its approach in this area in the future.

In summary, over its next decade, MCC should reinforce its commitment to policy performance by:

1) Maintaining a transparent, evidence-based system for identifying relatively well governed countries with which to partner;
2) Committing to rational and responsible use of the policy indicators that are used in such a system, rather than adhering to a strict interpretation of imprecise data; such rigidity can create uncertainty in MCC's programs that is counterproductive to the agency's core mission; MCC should maintain a keen and nuanced understanding of the strengths and limitations of the data, especially when interpreting the indicator scores of current partner countries;
3) Embracing subsequent compacts as a sensible way to continue to engage the right set of relatively well-governed countries;
4) Better explaining the threshold program rationale and establishing clear new metrics for success that demonstrate how the program is achieving its goal of helping countries become compact eligible, or eliminating the program entirely if such metrics are not determinable.

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[2] According to the 2014 Quality of Official Development Assistance (QuODA) index produced by the Center for Global Development and Brookings Institution, MCC ranked fifth of 102 agencies worldwide on the indicator "Share of allocation to well-governed countries," after Norway's NORFUND, the Portuguese Government, New Zealand's Ministry of Foreign Affairs and Trade, and Spain's Ministry of Industry and Energy. (This indicator uses the 2012 Worldwide Governance Indicators (WGI) as a chief input; MCC also relies on the WGI to inform how it decides to allocate aid.) In comparison, USAID ranks 82nd, reflecting its broader global engagement (rather than targeted aid according to governance practices) and its operational support of other US government policy objectives beyond development.

[3] A compact is MCC's hallmark investment partnership. It is an agreement between the country and MCC in which MCC provides large grant financing (around $350 million, on average) over five years for projects targeted at reducing poverty by stimulating economic growth. The threshold program is much smaller, accounting for only 5% of MCC's total program spending since 2004, with country programs designed to be completed in just two or three years and averaging around $20 million. Threshold programs support targeted policy reform activities to help a country achieve compact eligibility.

Congress and other MCC stakeholders should support the agency's continued commitment to policy performance by:

1) Supporting MCC's pursuit of subsequent compacts in a select set of countries;
2) Promoting responsible use of data by MCC and its Board.

The Role of Policy Performance in Country Eligibility

Background

Why Focus on Policy Performance?

MCC selects partner countries for compact eligibility based primarily on their policy performance in the areas of ruling justly, investing in people, and encouraging economic freedom. US government officials have regularly provided three reasons for targeting MCC's large-scale grants *only* to the best-governed developing countries.

(1) MCC Eligibility as a Reward

MCC eligibility is sometimes talked about as a *reward* of sorts to countries that are doing the right things with their own scarce resources. MCC was created at a time in which the development community increasingly understood that the development process is driven not by foreign assistance, but by the public policy decisions made by local leaders within developing countries. Within this intellectual framework, the primary responsibility for development (and stagnation) lay not in the hands of the World Bank or the US government, but within the halls of local institutions. Development assistance agencies could, at best, facilitate a positive process already underway (and, perhaps, provide support to stabilize security and deliver emergency relief). Thus, assistance provided by MCC was not seen as an entitlement to all poor countries, but rather as a reward of additional resources that the selected countries had *earned* by pursuing sound policies that contribute to the development of prosperous and democratic societies. As President George W. Bush explained in his announcement of the new Millennium Challenge Account (MCA):

> "*Good government is an essential condition of development, so the Millennium Challenge Account will reward nations that root out corruption, respect human rights, and adhere to the rule of law. Healthy and educated citizens are the agents of development, so we will reward nations that invest in better health care, better schools, and broader immunization. Sound economic policies unleash the enterprise and creativity necessary for development, so we will reward nations that have more open markets and sustainable budget policies, nations where people can start and operate a small business without running the gauntlets of bureaucracy and bribery.*" [4]

(2) MCC Selection as an Incentive

The second rationale for targeting MCC assistance to well-governed countries is the notion that the prospect of MCC eligibility provides an incentive for countries to improve their governance practices. As President Bush stated in his MCA announcement:

[4] President George W. Bush's remarks at the Inter-American Development Bank. March 14, 2002. http://www.presidency.ucsb.edu/ws/?pid=64974.

> *"Many developing nations are already working hard on the road -- and they're on the road of reform and bringing benefits to their people. The new Compact for Development will reward these nations and encourage others to follow their example."*[5]

This idea of MCC as an incentive, dubbed informally as "the MCC Effect," remains a strong element of the rhetoric within the institution. Observers both inside and outside of MCC have argued that the desire for the large-scale untied grant resources, as well as international recognition as a well-governed, market-friendly country, might lead developing country governments to undertake reforms *in order to qualify for a future compact*.[6] The provision in MCC's legislation for a "threshold program" for the countries that are close to meeting MCC's eligibility criteria also reflected the idea that early engagement with MCC might lead underperforming countries to improve their governance practices. In general, MCC officials have enjoyed pointing to the MCC Effect as a more palatable way for a donor to promote policy reform in developing countries – a carrot instead of the conditionality stick often used by other donors.

(3) MCC Selection as Contributor to Program Performance

The third rationale for targeting MCC assistance to well-governed countries was the idea that program implementation could be expected to be better and impact stronger in more conducive policy environments. As President Bush noted in his remarks announcing the establishment of the Millennium Challenge Account:

> *The lesson of our time is clear: When nations close their markets and opportunity is horded by a privileged few, no amount -- no amount -- of development aid is ever enough. When nations respect their people, open markets, invest in better health and education, every dollar of aid, every dollar of trade revenue and domestic capital is used more effectively.*[7]

As the basic foundations of MCC were being established, one reason the newly established institution gained strong bipartisan support was related to this emerging theory that foreign assistance programs would be more effective if they were implemented in a relatively well-functioning environment.

This idea had a strong intuitive appeal – take the exact same program and implement it in two communities with different governance characteristics and few observers would expect to find better implementation and impact in the community with more corruption, a less educated and less healthy workforce, and a more dysfunctional public service system. Moreover, when MCC was founded, there was relatively recent, well-known research that had found evidence of these dynamics at play. Burnside and Dollar (2000) and Collier and Dollar (2002) found that aid had a stronger relationship with growth in countries with stronger institutions. Similarly, Dollar and Pritchett (1998) found that foreign assistance, *when delivered to countries with good management*, spurs growth, crowds in private investment and reduces poverty. Yet, the authors found that the pattern of *bilateral* aid flows tended to provide roughly the same amounts to countries with *poor* management practices as to countries with good management practices (holding population and income levels constant), reflecting the

[5] President George W. Bush's remarks at the United Nations' International Conference on Financing for Development in Monterrey, Mexico, March 22, 2002. http://www.un.org/ffd/statements/usaE.htm
[6] MCC has a March 1, 2013 issue brief that documents some examples of what they consider to be the MCC Effect. Parks and Rice (2013) also found evidence that officials in many developing countries often consider MCC's eligibility criteria when thinking about reform efforts in a number of policy areas.
[7] President George W. Bush's remarks at the United Nations' International Conference on Financing for Development in Monterrey, Mexico, March 22, 2002. http://www.un.org/ffd/statements/usaE.htm

importance of political considerations (rather than expected results) in aid allocation decisions.[8] The current body of research on the relationship between aid, policies, and growth is now far from unanimous, but as MCC was being formed, this idea that providing foreign assistance to well-governed countries could actually improve the effectiveness of US bilateral assistance resonated strongly and the most recent research of the time appeared to support it.[9]

How MCC's Country Eligibility System Works

To identify the set of relatively well-governed countries with which to partner, MCC organizes a series of quantitative policy indicators, produced by independent third parties (e.g., the United Nations, the World Bank, the International Monetary Fund, Freedom House), into country scorecards. These scorecards are then published on MCC's website. Over the course of MCC's first ten years, there have been a few changes to the indicators used and the methodology for interpreting indicator performance, but the general basis for evaluation has remained largely constant.

Countries are assessed relative to their income-level peers (either low or lower-middle income) in three thematic categories: Ruling Justly, Investing in People, and Economic Freedom.[10] Currently, to meet the MCC's scorecard criteria to be considered for eligibility, a country must "pass" at least 10 of the scorecard's 20 indicators. For most of these indicators, a country passes by scoring above the median of its income-level peers. For a few indicators, MCC has established a fixed threshold. Most of these are a fixed minimum score that a country must score above to pass; one, Inflation, is a fixed maximum score that a country must score below to pass. MCC also requires countries to pass at least one indicator in each of the three categories. Finally, there are two "hard hurdles" that a country must pass to meet the minimum standard for scorecard performance. The Control of Corruption indicator has been a hard hurdle from the outset (a country must score above the median in its income category), and a new democracy hard hurdle was added in FY2012 (a country must score above a set threshold on either the Political Rights or Civil Liberties indicator). In general, a country must meet all of these indicator criteria to be considered for compact eligibility. For threshold program eligibility, a country must either meet or be very close to meeting these criteria.[11]

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[8] However, the authors also found that lower-middle income countries with good management practices received 30% more in multilateral aid than similar countries with poor practices.

[9] Subsequent studies (Easterly, Levine, and Roodman, 2004; Roodman 2007) questioned the robustness of the results from Burnside and Dollar (2000) and Collier and Dollar (2000). The debate continues, however. For instance, Denizer, Kaufmann and Kraay (2011) found that the strength of institutions correlates with project outcomes at a country level, but that the quality of project design and management correlate with outcomes within countries.

[10] MCC employs two definitions of low income countries (LIC) and lower-middle income countries (LMIC), both of which are different from the standard World Bank definition. From FY2004 through FY2011, MCC used only one definition of LIC and LMIC. MCC LICs were countries with a per capita income below the World Bank's historical cutoff for International Development Association (IDA) eligibility. MCC LMICs were countries with per capita income above the historical IDA cutoff and below the World Bank-defined LMIC income ceiling. Since FY2012, MCC has used a dual definition of LICs and LMICs. For the purposes of comparing countries' relative performance on the scorecards, MCC maintains its former categorizations. For purposes of funding, the two categories are defined differently. Under this definition, LICs are the 75 lowest income countries, and LMICs are the cohort that begins with the 76th lowest income country and is capped by the World Bank's per capita income ceiling for LMICs. MCC's legislation was amended to include this additional definition to better align how funds can be allocated with the relative distribution of countries within the candidate groups. By law, MCC can use no more than 25 percent of its budget for LMIC compacts and, over time, as countries graduated from LIC to LMIC, the LMIC group started to grow to be far larger than 25 percent of the candidate pool. For purposes of this paper, LIC and LMIC refer to the original MCC definition of the categories, the definition used for scorecard comparisons.

[11] How MCC interprets "close" to meeting the criteria has evolved over the years. In MCC's earlier years, a country could have been two to three indicators away from fully meeting the criteria and have been selected for threshold program eligibility. In recent years, countries selected for the threshold program either already meet the indicator criteria or miss by only one indicator.

In selecting the specific indicators to use on the scorecard, MCC considered a number of characteristics, including:

- *Good country coverage:* Because MCC mostly compares countries' scores *relative to one another*, it is important that an indicator have data for as many MCC candidate countries as possible in order to get the most accurate picture of relative performance (also, since MCC treats missing data as a failing score it seeks to minimize failure due to lack of data);
- *Regular periodicity:* MCC's scorecard data will never reflect up-to-the-minute policy performance, but since more recent data is better, preferred indicators are those whose data are updated regularly, preferably annually;
- *Developed/vetted by a third-party:* The indicator data should not come from MCC nor directly from a candidate country to avoid perceptions of manipulation;
- *Public availability:* In the interest of transparency and accountability, MCC seeks indicators in the public domain; and
- *Linked to poverty reduction and economic growth:* To the extent that MCC seeks to reward countries for pursuing policies conducive to growth or incentivize them to do so, the criteria used to select countries should be plausibly linked to these outcomes.[12]

The scorecard is the public and transparent face of MCC's selection process. However, the indicators are an imperfect and incomplete reflection of actual contemporaneous governance performance. This is due to:

- *Time Lags*: Most data have at least a one-year time lag. As a result, current scorecards reflect *past* performance that may have improved or worsened by the time MCC uses them to make eligibility decisions.
- *Imperfect Policy Performance Proxies*: An individual indicator does not necessarily capture everything about the specific policy area, several indicators contain subjective elements, and numeric scores cannot explain *why* a country performs the way it does.[13]
- *Indicator Gaps*: Indicators are not available for all of the policy areas MCC is required to consider per its legislation (e.g., the rights of people with disabilities).
- *Data Imprecision*: Most scorecard indicators are a "best estimate" within an often unknown margin of error; year-to-year movements and differences between countries can be so small as to be indistinguishable with standard understandings of statistical confidence.

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[12] MCC has compiled a substantial body of literature that supports the link between the policy areas the scorecard seeks to measure and poverty reduction and economic growth (see MCC's Guide to the Indicators and the Selection Process for Fiscal Year 2014). Radelet (2003) undertook simple statistical tests on the association between the original set of MCC's eligibility indicators and key development outcomes including growth and found that over half the indicators were significantly correlated with growth. However, no clear pattern of higher average growth among countries that pass the scorecard compared to those that do not pass has emerged.

[13] Subjectivity is not necessarily an inappropriate indicator characteristic. Perceptions can contribute important de facto information about policy areas that do not easily lend themselves to concrete measurement (e.g., political governance). However, they can be affected by biases, ignorance, conceptual inconsistencies, or other error. For instance, Kenny (2014) reported, "Ask the same people, 'Have you paid a bribe,' and then ask, 'Is corruption a problem in this country?' and the relationship between the two answers is weak." He finds the same is true for surveys of businesses. In general, the institutions that produce subjective "expert assessment" indicators undertake extensive vetting to ensure that their analysts' subjective ratings are broadly comparable across countries and across time. However, some biases and other subjective errors may persist and skew the data. The Worldwide Governance Indicators (MCC uses three of them on its scorecard) aggregate a number of subjective ratings and calculate a margin of error for their governance estimates based on factors such as bias and other subjective errors that are uncorrelated across sources. While this goes a long way toward helping users understand the imprecision of the estimates, they do not account for the full range of subjective error that may exist (e.g., bias from errors correlated across sources).

For these reasons, MCC also looks at supplemental quantitative and qualitative information to acquire a more complete picture of a country's policy performance. While MCC makes public a list of the kind of supplemental information it uses and the possible sources of this information, it does not systematically publish summaries of the extra information taken into account for particular countries, creating the potential for important gaps between the published country scorecards and actual institutional assessments of country policy performance.

While policy performance is the primary consideration for MCC eligibility, two additional factors are laid out in MCC's legislation. First, MCC must consider how much money it has available; the Board can decide *not* to select countries that pass the scorecard if it feels the funds available would be better distributed across a smaller number of country programs. Second, MCC must consider "the opportunity to reduce poverty and generate economic growth in the country." This latter, somewhat vague criterion generally means that MCC should not select a country that otherwise meets the scorecard criteria if there is good reason to believe that MCC could not develop or implement a sound compact with that country (e.g., if bilateral relations are strained, if current policies are not aimed at promoting broadly shared market-led economic growth). There is no formal definition for this criterion, and its application has been somewhat ad hoc over time.

MCC's Board of Directors is responsible for country eligibility decisions, which are normally made once annually (usually in December) and tied to a fiscal year. Once the Board selects a country as eligible, funds appropriated to MCC for that fiscal year can be used to develop or implement a compact with that country. Typically, once a country is initially selected as eligible, it will need to be reselected for several subsequent fiscal years to enable it to continue compact development. Once a respective country signs a compact (or threshold program agreement), the total funding amount is obligated. As such, it no longer needs to be formally reselected as eligible for future funding.

MCC's Eligibility Record: Does the Focus on Policy Performance Depoliticize Decisions?

MCC's selection process was intended to depoliticize eligibility decisions. MCC's record on selection overwhelmingly suggests the prioritization of policy performance as the main criterion for eligibility. There have been a few exceptions, however, with certain eligibility decisions appearing to support broader US government political and diplomatic interests in a way that is inconsistent with the spirit of MCC's formal eligibility system. However, in most of these cases, the Board seems more willing to use MCC's smaller tool—the threshold program—than the more highly visible, results-oriented, and resource-intensive compact program.

MCC's largely transparent, indicator-based system for assessing countries' policy performance was intended to minimize pressures to select countries for reasons other than policy performance. As noted previously, bilateral aid patterns have often reflected political and historical relationships. European bilateral aid flows often reflects past colonial ties, and USAID funding is often observed to follow a pattern reflecting its current geopolitical interests.[14] For the latter, this includes both the need to provide relatively large amounts to a small number of strategic partners and the desire to have a recognized presence almost everywhere. The MCC selection process was created not only to help identify the best partners but also to insulate the institution from these almost natural political pressures to use foreign assistance as a tool for non-development objectives. To what extent has MCC's selection system operated this way in practice?

[14] For example, between 2004 and 2012, six of the top ten recipients of French official development assistance (ODA) commitments were former French colonies, and six of Portugal's top ten ODA recipients were former Portuguese colonies. Seven of the United Kingdom's top ten ODA recipients were former British colonies. Fully one-quarter of US ODA commitments between 2004 and 2012 went to just three strategic countries: Iraq, Afghanistan, and Pakistan. All data come from the Organisation for Economic Co-Operation and Development's Creditor Reporting System.

To examine this, one must assess whether MCC's selection system has helped to depoliticize eligibility decisions. As a US government agency, MCC is necessarily an instrument of US diplomacy. Its Board is chaired by the Secretary of State, and a majority of the board members come from US government agencies.[15] Therefore, under most conditions, most Board members can be expected to defer to the Secretary of State on matters of foreign policy *as defined by the Department of State*. Given this structure, it is reasonable to expect that State Department preferences will prevail on issues of significant importance. But this should not be interpreted as meaning that the "independent" Board is totally ineffective in shielding MCC from political interference.

MCC management and staff prepare and structure Board meetings and always have the opportunity to press for selection decisions that are evidence-based and as consistent as possible with a country's policy performance. Because MCC management and staff are the ones who must deal day-to-day with the repercussions of difficult-to-defend decisions, they are not reluctant to argue before the Board either in support of, or in opposition to, selection decisions under consideration.

Moreover, the Board was structured to include four private (non-governmental) board members expressly to provide independent, credible voices that would not necessarily have to weigh the diplomacy and development trade-offs in exactly the same fashion as the sitting administration. While this Board minority cannot outvote the government bloc, the threat of a five-to-four split along government-private lines could give a real or perceived signal that the State Department is overstepping its mandate, and such a divide would not stay private very long.[16] In practice, the Board meetings have tended to avoid highly contentious and problematic outcomes, such as those that reflect the prioritization of US diplomatic interests over development impact.

Board meeting proceedings (and pre-meeting deliberations) are not open to public scrutiny, so it is not possible to systematically and unambiguously discern the primary factors behind each eligibility decision. However, MCC's record on selection overwhelmingly suggests the prioritization of policy performance over politics. The main factors that support this anecdotal observation include:

- Over the first ten years of its existence, only two countries have ever been newly selected for compact-eligibility despite not passing the indicator criteria: Georgia (twice) and Mozambique (once). The vast majority (93 percent) of countries selected by the Board met the indicator criteria at the time they were first selected. In the cases of Georgia and Mozambique, the decision to select despite the country failing to meet the formal eligibility criteria had some plausible basis in the supplementary data.[17] Nonetheless, the selection of these two countries, particularly Georgia (the first time) has been cited as evidence that the Board is willing to override established criteria to ensure

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[15] The Board is made up of the Secretary of State, the USAID Administrator, the Secretary of the Treasury, the US Trade Representative, and MCC's CEO, as well as four private, non-governmental members. These four spots are filled by individuals suggested by Congress (one each from the majority and minority leaders of the House of Representatives and the Senate), appointed by the President, and confirmed by the Senate.

[16] In fact, after the December 2013 board meeting, MCC strongly suggested that the decision of whether or not to reselect Benin and Sierra Leone for continuing compact eligibility was unprecedentedly not put to a vote because of this very reason. MCC stated in public remarks after the Board meeting that, had the decision been put to a vote, all of the private Board members would have cast their lot against reselection. This statement suggested that a vote would likely have created a split along government-private lines, an outcome the Board presumably wished to avoid.

[17] Both Mozambique and Georgia were both among the initial tranche of countries selected for MCC compact eligibility in May 2004. In both cases, MCC was aware of substantial reform efforts that had taken place since the data reflected on the scorecard were collected, and was convinced that both countries would fully meet the criteria in the near future; on this count they were right. The other time Georgia was initially selected as eligible (this time for a second compact) despite not passing the formal indicator criteria, the country fell short by one Investing in People indicator; however, MCC found the data did not reflect major policy concerns (see MCC's Report on the Selection of Eligible Countries for Fiscal Year 2011 for more detail on the agency's justification for selecting Georgia).

support for a geopolitical ally, thereby weakening the perception that MCC eligibility decisions are completely insulated from political interference. Since the agency's first round of selection in 2004, however, MCC has been more inclined to wait until existing reform efforts are reflected in the indicators before selecting a country.

- The list of compact and threshold program eligible countries includes a majority of countries that are not typically politically strategic partners (see figure 1 below).[18] Of course, the list also includes a number of countries that are strategic allies, but their MCC eligibility is supported by their policy performance.[19] That is to say, MCC has not generally *overridden* its eligibility criteria to select political or strategic allies (with the aforementioned exception of Georgia).

Figure 1: Compact and Threshold Eligible Countries, By Date of Initial Selection

Fiscal Year	Compact Eligible	Threshold Eligible
FY04	Armenia	Albania
	Benin	Kenya
	Bolivia	Sao Tome & Principe
	Cape Verde	Tanzania
	Georgia	*Timor-Leste*
	Ghana	Uganda
	Honduras	*Yemen*
	Lesotho	
	Madagascar	
	Mali	
	Mongolia	
	Mozambique	
	Nicaragua	
	Senegal	
	Sri Lanka	
	Vanuatu	
FY05	Morocco	Burkina Faso
		Guyana
		Malawi
		Paraguay
		Philippines
		Zambia
FY06	Burkina Faso	Indonesia
	The Gambia	Jordan
	Tanzania	Kyrgyz Republic
	Timor-Leste	Moldova
	El Salvador	Ukraine
	Namibia	
FY07	Jordan	Niger
	Moldova	Peru
	Ukraine	Rwanda
FY08	Malawi	Albania**
	Philippines	*Mauritania*
		Paraguay**
		Zambia**
FY09	*Colombia*	Liberia
	Indonesia	Timor-Leste
	Zambia	
FY10	Cape Verde*	

[18] Given the fact that the indicators can be seen as reflecting an American view of development as driven by open and transparent governments and open and competitive markets, no one should be surprised to find that most of the countries that generally perform well on these governance indicators are also at least friendly to the US.
[19] For example, Mongolia was a member of the "Coalition of the Willing" (countries that supported the US invasion of Iraq in 2003).

FY11	Georgia* Ghana*	*Tunisia*
FY12	Benin* El Salvador*	Nepal Honduras
FY13	Liberia Niger Sierra Leone Morocco* Tanzania*	Guatemala
FY14	Lesotho*	

** denotes eligibility for a second compact*
*** denotes eligibility for a second ("stage II") threshold program*
Italicized countries were selected as compact- or threshold-eligible but did not end up signing an MCC compact or threshold program due to: suspension/termination of eligibility (the Gambia, Mauritania, Yemen), non-continuation of eligibility during compact development (Bolivia, Sri Lanka, Timor-Leste, Ukraine), graduation out of MCC candidate country status during compact development (Colombia), selection as compact-eligible before developing a threshold program (Timor-Leste), or a change in law that prevented MCC from funding a threshold program with a country whose income exceeded the MCC candidacy ceiling (Tunisia).

There are, however, some clear (and some questionable) exceptions to MCC's generally solid record of selecting countries according to policy performance. The following examples suggest US government political or diplomatic considerations mattered more than policy performance in some cases:

- ***Compact Eligibility for Jordan***: Jordan technically met the indicator criteria the year it was selected (FY2007), as it did every year it was an MCC candidate country. However, it exhibited consistently weak performance on the indicators that measure democratic rights and practices. MCC did not introduce a "hard hurdle" on democracy until FY2012, so Jordan's selection was not technically contrary to MCC rules. However, the Board had, from the beginning, revealed its informal preference of selecting only countries that passed at least one of the three democracy indicators.[20] Jordan was the only country in MCC's history that did not pass at least one of these indicators when it was first selected.[21] It is also a key strategic ally, which many observers believe suggests that the State Department may have elevated diplomatic interests over consistency in the application of the governance indicators in this particular decision.

  However, not all evidence fully corroborates this view. Egypt also fit the profile of a non-democratic ally that met MCC's formal indicator criteria for many years. Yet, it was never selected, despite being one of the largest recipients of US foreign assistance during the past decade. Moreover, Jordan, unlike Egypt, had accepted a threshold program that focused explicitly on strengthening democratic institutions, providing important supplementary evidence that Jordan was willing to engage on these issues, even if it did not pass the criteria. That said, neither the results of the threshold program nor the quality of the government of Jordan's partnership in the threshold program were taken into account when considering compact eligibility. The threshold program had been signed *just weeks before* Jordan was selected for a compact.[22]

  The case that diplomatic interests at the Board level trumped consistency in decision making is a strong one, but an alternative case can be made that Jordan's selection was sufficiently justified as a special case that was consistent with the letter of the selection process rules (which did not include a

[20] The Board regularly passed over countries like Ethiopia, Rwanda, and Vietnam which met the indicator criteria but registered below-median performance on the three democracy indicators.
[21] Some may also point to Morocco as another example of a non-democracy selected by MCC. However, the year it was first selected it did pass one of the three democracy indicators, the Voice and Accountability indicator (which was dropped from the scorecard in FY2012).
[22] This apparently odd timing of selecting countries as compact-eligible only just as threshold programs (which are intended to help a country secure compact eligibility) are getting underway was not unique to the case of Jordan. For example, Burkina Faso was selected as compact eligible just months after singing a threshold program, and Moldova's threshold program was signed after the Board selected it as eligible for a compact.

democracy hard hurdle at the time) and with the government of Jordan's willingness to commit to engaging with MCC on a threshold program. This case highlights that even where geopolitics were arguably a factor, they did not lead to a decision that was explicitly and objectively inconsistent with MCC's criteria for policy performance.

- ***Threshold Program Eligibility for the Kyrgyz Republic***: When the Kyrgyz Republic was selected for threshold program eligibility in FY2006, it scored below the median on all six Ruling Justly indicators, including the Control of Corruption hard hurdle and all three democracy indicators. Of course, the Kyrgyz Republic had just overthrown an authoritarian ruler and held national elections, so presumably performance at least on the democracy indicators would register some improvement in the near term. Even so, it is difficult to make the case that the Kyrgyz Republic was "close" enough to meeting the compact eligibility criteria when it was chosen to be a threshold program candidate. Instead, its selection gave the appearance that the MCC Board (reflecting the broader interests of the US government) may have been looking for opportunities to support a nascent democratic movement in a country that, incidentally, hosted a US military air base that supported American operations in Afghanistan. Had the Kyrgyz Republic been selected for a *compact*, the inconsistent application of selection rules would have been obvious; in the context of a *threshold program*, the decision to provide a small program focused on governance reform to a new democracy seems more of a bending of guidelines—guidelines that were never made explicit about how "close" a country should be—rather than explicitly breaking them.

- ***Threshold Program Eligibility for Honduras***: Honduras was selected for the threshold program in FY2011, just after completing its first compact. Though the compact was implemented well with strong government commitment, Honduras was passed over for a second compact. The country no longer passed the hard hurdle Control of Corruption indicator and was dealing with the aftermath of its 2009 coup and an increase in violence.[23] It seems likely that these policy issues were sufficiently concerning to the Board to withhold eligibility for a second compact, given that Honduras' implementation of the first compact offered no red flags. The unprecedented step backwards from compact to threshold program status seemed to reflect US diplomatic interests to express unhappiness with the recent events and signal the importance of performance on the Control of Corruption indicator (especially at what would have been the point of initial selection for eligibility for a new compact) but also to offer a consolation prize to an important regional ally.[24]

- ***Threshold Program Eligibility for Tunisia***: Tunisia was selected for the threshold program in FY2011, in the wake of the Arab Spring.[25] In terms of MCC scorecard performance, Tunisia was not an unreasonable candidate for the threshold program, although, like the Kyrgyz Republic, its policy environment probably could have been described as more "uncertain" than "promising" or "improving." At the time of its selection, Tunisia passed only nine indicators, one short of the requisite minimum of ten. In addition, Tunisia failed all three of the democracy indicators, but MCC could reasonably, or at least optimistically, expect the country's performance in this area to improve dramatically once the events of 2011 were reflected in the data.

  The problem is that when Tunisia was selected, MCC *already knew* that Tunisia's income level would be too high for the coming fiscal year (FY2012) to be a candidate country. In other words, MCC knew that a threshold program could not plausibly help Tunisia become compact eligible, consistent with language in the authorizing legislation that describes the purpose of the threshold program,

[23] In particular, rising violence against journalists raised questions about the trajectory of press freedom in Honduras.
[24] The distinction between *initial selection* for compact eligibility and annual *reselection* throughout the compact development process is discussed in detail in the following sections.
[25] Though most FY2011 eligibility decisions were made at the Board meeting in December 2010, a special, off-cycle eligibility decision was made for Tunisia at the September 2011 Board meeting, right before the end of the fiscal year.

because Tunisia's income would be too high for the country to even be considered. The *only* plausible explanation for its selection was that the Board wanted to use MCC funds, consistent with broader US diplomatic interests, to support a strategic ally in its transition to democracy. The willingness of the Board, led by the Secretary of State, to use MCC for objectives inconsistent with the agency's mission (and authorizing language) troubled many MCC staff, members of Congress, and independent supporters as undermining the institution's credibility.[26]

- ***Non-Selection of Many Small, Well-Governed Countries***: At least five small countries have had consistently good policy performance but have been regularly overlooked by MCC.[27] MCC has suggested that small countries are a lower priority because MCC may have less opportunity to reduce poverty and generate economic growth, and that they are not the best use of scarce resources.[28] Compact development and implementation typically entail a fixed amount of staff time and financial resources, regardless of the size of the compact. This makes smaller compacts accorded to microstates less efficient, with smaller economies of scale (MCC management and staff understand this concern, but it has not been used as part of a public explanation for non-selection). While considerations of scale and efficiency were likely of primary importance, another factor that may have contributed to MCC's passing over well-performing small countries is their relatively low political importance. Large countries, even if not of strategic importance, carry some level of importance that cannot be matched by very small countries. In particular, MCC may have been concerned about perceptions by Congress if its pipeline seemed to be dominated by small, less strategic countries.

The pattern that emerges from this evidence suggests that the MCC Board at times has been willing to make minor or modest compromises with the MCC selection process to allow (or force) the agency to operate in support of broader US government diplomatic interests in a way that was inconsistent with *the spirit of* its formal model. When it has done so, the Board appears to have been more willing to use MCC's smaller tool—the threshold program—than the more highly visible and resource-intensive compact program. While this is not the originally intended use of the threshold program, it arguably may have served as a useful buffer against the politicization of MCC compacts, allowing the Board to make decisions that advance US diplomatic interests without undermining the core development function of the flagship compact program.

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[26] In the FY2014 omnibus appropriations bill, Congress effectively prevented MCC from proceeding with a threshold program for Tunisia by saying "that none of the funds made available by this Act or prior Acts making appropriations for the Department of State, foreign operations, and related programs shall be available for a threshold program in a country that is not currently a candidate country." While the effect of this provision is reasonable for the Tunisia threshold program, the language is troubling for the precedent that it sets in terms of Congress using legislation to negate eligibility decisions made by MCC's Board.

[27] MCC has no official stance on small countries and has chosen to partner with some of them. Cape Verde (population 501,000) is implementing its second compact, and Vanuatu (population 246,000) completed a compact in 2011. However, many other small population countries have not been selected despite passing the indicators. For instance, Guyana (population 756,000) passed the indicator criteria for six of its eight years in the low-income country category; Samoa (population 184,000) passed as a lower-middle income country for six out of nine years; Kiribati (population 100,000) passed the indicator criteria for six of eleven years; Sao Tome and Principe (population 169,000) has passed for the last three years in a row; and Comoros (population 754,000) has passed for the last two years. None have been selected as compact eligible.

[28] For example, MCC's Eligible Country Report for FY2009 states that a number of countries that met the indicator criteria were not selected as eligible because of other factors like, "the country's commitment to fighting corruption and promoting democratic governance; the availability of appropriated funds; and the countries in *which MCC would likely have the best opportunity to reduce poverty and generate economic growth*" (italics added). While size is not explicitly mentioned, the primary rationale that could apply to the small countries from this set of examples is the perceived weakness of opportunity to reduce poverty and generate economic growth.

While certain Board decisions have contributed to a public perception that the MCC selection process is heavily influenced by diplomatic interests, a more systematic examination of the entire record suggests that *there are no egregious examples of poorly-governed countries being selected*, a remarkable track record that both confirms the original structure and process of the selection process as largely consistent with an institution whose mission and integrity are driven mostly by aid effectiveness rather than US geopolitical considerations.

The Policy Performance Case for Subsequent Compact Eligibility

Many of MCC's early compacts either already have been concluded or will do so in the next year or two. Since few new countries pass the scorecard criteria each year, there are few new prospects for compact eligible countries. In response, MCC has begun entering into subsequent compacts with a select set of countries that have completed initial compacts and maintain strong policy performance. This is a sensible approach. On the whole, MCC is currently partnering with the right set of relatively well-governed countries, many of which will continue to be strong partners in the future. If these current partners maintain good governance and demonstrate commitment to successful implementation of their prior compact, it makes little sense to disqualify them from further support solely on the basis of having had a compact in the past.

A decade in, MCC is at a crossroads. Many of its early compacts are already completed or coming to a close. Moreover, there are few new countries emerging as viable partners. In response to this dynamic, MCC is increasingly entering into second compacts with countries.[29] Though MCC's founding legislation expressly allows MCC to enter into one or more follow-on compacts, some reservations about this approach persist, particularly among some stakeholders in Congress and US development NGOs.

One of the sources of opposition to subsequent compacts is the idea that the need for a subsequent compact is a sign that the first compact failed. In MCC's early days, agency officials often talked about compacts as "transformational," but without defining what this meant or could reasonably mean. Among the interpretations that emerged was the notion that a "successful" compact would mean ridding a country of a need for future development assistance. No donor, however, and certainly not a single five-year compact—no matter how good it is—can catalyze growth of such magnitude that a country would will graduate from "developing" to "developed" status.[30] "Transformation" is simply not a reasonable expectation of success.

Another hesitation about MCC's pursuit of subsequent compacts is that engaging with a country on an ongoing basis eliminates the distinction between MCC and other forms of US foreign assistance. However, the compact's time limit is not the only distinction between MCC's approach and the way much of other US foreign assistance is delivered. MCC incorporates in new ways a number of important aid effectiveness principles, including: having a single, defined objective; incorporating country ownership from program development through implementation; and taking a much more rigorous approach to predict, track, and evaluate cost-effective results. Subsequent compacts in a single country enable MCC to institutionalize and strengthen these practices as part of a longer-term development partnership. In addition, consecutive partnership does not mean continuous support. MCC compacts have a five-year time limit, but the importance of this limit is not in its application to MCC's relationship with a country, but in its application to each compact. The five-year clock creates incentives for expedient implementation, forces a firm exit point,

[29] To date, seven countries have been selected as eligible to develop a second compact (Cape Verde, Georgia, Ghana, Benin, Morocco, Tanzania, and Lesotho). One or more countries has been selected as eligible for a second compact each year since the FY2010 selection round.

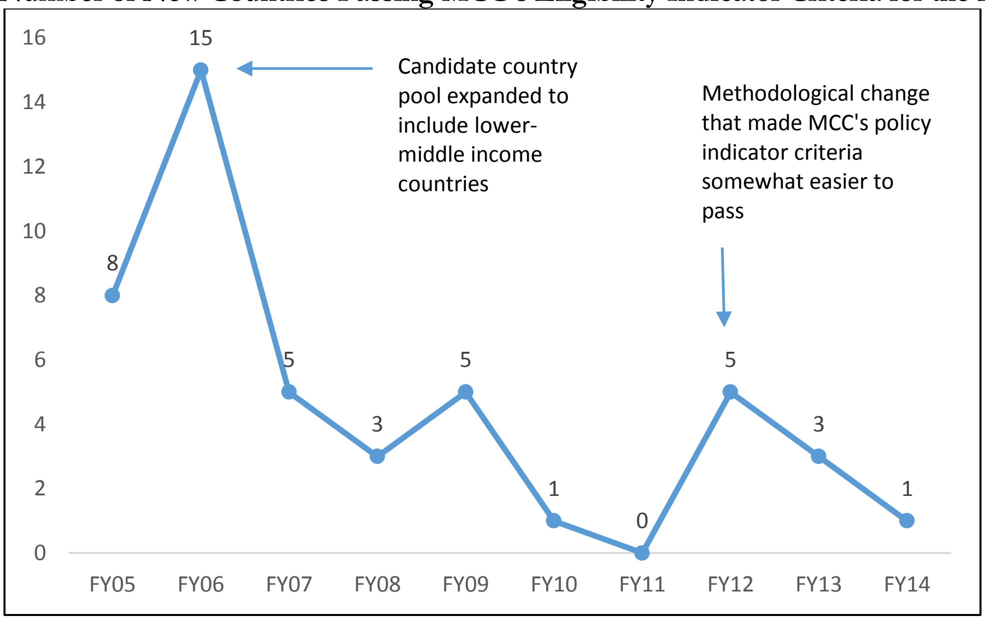
[30] By illustration, Tanzania's compact would have had to increase income per capita by over 900% (more than 50% per year) to move the country from low- to upper-middle income. There was no possibility of this happening.

and provides a specific juncture at which MCC must specifically assess whether to pursue another partnership with the country in the future (subsequent compacts are not automatic).[31]

A further, fundamental argument for subsequent compacts, however, relates to MCC's founding precept that policies matter. In short, the best MCC partner countries—the relatively well-governed low and lower middle income countries of the world—are increasingly those with which the agency is already working.

Experience over the last decade shows that the set of countries that meet the scorecard criteria changes very little from year-to-year. As figure 2 shows, few new countries pass the scorecard in any given year. Of the handful of newly passing countries, only roughly half end up passing on a consistent basis (i.e., more than just one or two years), and nearly a quarter are micro-states (population <1 million). Simply put, there are not many strong *new* contenders for MCC eligibility emerging.

Figure 2: Number of New Countries Passing MCC's Eligibility Indicator Criteria for the First Time



The alternatives for expanding the list of MCC partner countries beyond current and former compact countries include the following largely undesirable or impractical options.

- ***Making it increasingly easier to meet the policy performance standards for eligibility.*** Each year only around a third of MCC candidate countries pass the indicator criteria for eligibility, but changes to the indicators used and/or the rules that decide minimally acceptable performance could increase this proportion. Of course, each adjustment would most likely result in a one-time increase in the number of countries that pass, so for MCC to have a regular pipeline of newly passing countries, the scorecards would have to get progressively easier to pass. This approach would likely draw strong opposition.

- ***Allowing higher-income countries to compete for eligibility.*** Currently, only low and lower-middle income countries are candidates for MCC assistance. Changing the legislation to expand this pool to upper middle income countries would give the agency more options. However, most upper

[31] Rose (2014) explores these arguments and others in more detail.

middle income countries have far more access to other sources of capital and should not be high priorities for MCC grant financing.[32]

- ***Choosing more micro-state partners.*** As mentioned above, MCC has passed over a number of small (mostly island) countries that have demonstrated fairly consistently good performance on MCC's policy indicators. If MCC were forced to work only with *new* countries that pass its scorecard criteria, it would largely become a fund for micro-states.[33]
- ***Working with sub-national units.*** Legally, MCC can select just part of a country, such as a province or a city, as an eligible entity, though it has never done so in practice. This option would provide MCC the ability to work with a relatively well-governed locality within a country that, as a whole, may not meet MCC's policy performance criteria. A serious challenge to this approach, however, is the difficulty identifying sub-national units for prospective partnership. MCC has long stressed the importance of using high-quality, transparent, and broadly comparable data to evaluate countries' policy performance, but this type of information does not exist for sub-national units within most developing countries, much less across countries.
- ***Entering into regional compacts.*** This approach is potentially worth exploring, but it is far from straightforward. Fundamentally, MCC lacks the legal authority to select groups of countries in a way that would facilitate regional compacts, and beyond that constraint, there are a number of practical challenges to operationalizing the concept, including, but not limited to, the potential arbitrariness of defining regions based on which countries pass MCC's scorecard and dealing with potential suspension or termination of individual countries in a region. In addition, a regional approach does not obviate the question of subsequent compacts since country parties to a regional agreement would most likely currently have or have completed a separate bilateral compact.

All this suggests that MCC's alternatives to pursuing subsequent compacts are either shifting away from its mandate to work exclusively with poor, well-governed countries or closing its operations, probably within the next decade. Neither of these is the right choice. MCC is meant to pick the best places to put its resources. On the whole, it is currently partnering with the right set of countries, many of which will continue to be strong partners in the future. If these current partners maintain good governance and work well with MCC to reduce their country's binding constraints to growth, disqualifying them from further support solely on the basis of having had a compact in the past is counter to the core aid effectiveness principles that MCC espouses. Subsequent compacts are a clear choice for MCC's future operations if the agency's founding precept that policies matter is to remain an important governing principle.

Recommendations

MCC should:

1. **Continue to minimize the elevation of diplomatic interests over and above the consideration of policy performance for country eligibility.** The US government has a wide range of other foreign assistance tools to support geostrategic partners that do not meet the policy criteria for compact or threshold program eligibility.

[32] For instance, in Brazil, which has one of the highest rates of income inequality in the world, ten percent of the population lives on less than $2 per day. Yet the country maintains an investment grade credit rating and in 2012 took in $76 billion in foreign direct investment net inflows, the largest volume in the world after the United States and China (source: World Bank World Development Indicators). In such a context, the funds from a large MCC compact would be dwarfed by the other forms of finance available to the Government of Brazil.

[33] A case could be made for MCC engagement in some of these countries in the future, though issues related to scale and efficiency would require serious consideration.

Congress and other MCC stakeholders should:

1. **Embrace subsequent compacts as a sensible way for MCC to continue to work with well-governed countries.** MCC should not be arbitrarily limited to a set number of compacts per country. It should retain the flexibility to have follow-on compacts (in the absence of a deterioration in policy performance or weak commitment to compact implementation by the partner country) until it no longer makes sense for MCC to support country-led solutions to growth in that country. Stakeholders should push MCC to implement subsequent compacts effectively rather than pressuring them not to do them.

Revoking Eligibility (e.g., Suspension, Termination)

Background

In addition to selecting countries based on policy performance, MCC can signal the importance of policy performance by curtailing or ending its partnership with a country (either in the eligibility phase or the implementation phase). Per MCC's suspension and termination policy, the MCC's Board can suspend or terminate (in whole or in part) eligibility for or assistance to a country that has engaged in "a pattern of actions inconsistent with the criteria used to determine the eligibility of the country."[34] MCC can also place compact funds on hold, which, if not subsequently released, is the functional equivalent to a partial suspension or termination. MCC can also opt not to reselect a country for eligibility during the program development stage (i.e., before the compact or threshold program agreement is signed).[35]

Revocation of Eligibility Due to Policy Declines

MCC has demonstrated its willingness to revoke eligibility or funding when a country's policy performance declines. The most common reason for suspension, termination, or non-reselection has been backsliding on democratic rights and civil liberties. MCC has also cited corruption as a rationale for eligibility revocation, though identifying when a country's anti-corruption environment has sufficiently deteriorated to warrant discontinuation of the partnership has proven difficult.

MCC has demonstrated that it is, in fact, willing to truncate or revoke eligibility for funding to countries based on policy performance declines. Over the course of MCC's first ten years, as figure 3 shows, it has done so via suspension, termination, an operational hold, or a decision not to reselect during program development for 13 of the 35 countries selected for compact eligibility (37%) and three of the 28 countries selected for threshold program eligibility (11%).[36]

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[34] MCC may also suspend or terminate due to engagement in activities contrary to US national security interests or failure to adhere to responsibilities under the compact or threshold program. Policy on Suspension and Termination. http://www.mcc.gov/pages/about/policy/policy-on-suspension-and-termination

[35] Theoretically, a country that is not reselected remains eligible to use funds from the fiscal years in which they were selected, but in practice, not being selected in subsequent years has typically signaled the end of MCC's relationship with a country. This was uniformly the case until FY2014 when MCC chose not to reselect Benin and Sierra Leone, both of which were in the process of developing compacts based on their selection in prior fiscal years. For these two countries, MCC offered the mixed signal of suggesting "continued but limited engagement," with substantial uncertainty about whether they would be selected again in the near-enough future to warrant continued work toward a compact.

[36] This counts unique country partners, not instances of selection. Countries are counted only once, even if they were selected for a second compact or stage II threshold program.

Figure 3: Revocation of MCC Eligibility or Assistance[37]

Country	Action	Justification
COMPACTS		
Implementation phase		
Armenia	Hold on funds (partial, indefinite)	Concerns about the conduct of an election, post-election violence, and restrictions on press freedoms
Honduras	Termination (partial)	Undemocratic change in government
Madagascar	Termination (full)	Undemocratic change in government
Malawi	Suspension (full), later reinstatement	Concerns about restrictions on press freedoms and freedom of assembly, arrests of opposition and human rights leaders
Mali	Termination (full)	Undemocratic change in government (military coup)
Nicaragua	Suspension (partial), later termination (partial)	Concerns about the conduct of an election
Eligibility (compact development) phase		
Benin	Not reselected	Below-median score on the Control of Corruption indicator
Bolivia	Not reselected	Reason not provided, but likely due to deterioration in bilateral relations and concerns about economic governance
The Gambia	Suspension	Concerns about human rights abuses, restrictions on political rights, civil liberties and press freedom, deteriorating economic policies and anti-corruption efforts
Sierra Leone	Not reselected	Below-median score on the Control of Corruption indicator
Sri Lanka	Not reselected	Reason not provided, but likely due to continuation of civil war
Timor-Leste	Not reselected	Reason not provided, but likely due to political unrest (assassination attempts); a below-median score on the Control of Corruption indicator may also have factored in
Ukraine	Not reselected	Reason not provided, but likely due to weak commitment to MCC partnership/compact development; a below-median score on the Control of Corruption indicator may also have factored in
THRESHOLD PROGRAMS		
Implementation phase		
Niger	Suspension (full), later reinstatement	Concerns about actions to extend and consolidate presidential power and retaliation against opposition
Eligibility (program development) phase		
Mauritania	Termination	Undemocratic change in government (military coup)
Yemen	Suspension, later reinstatement, later termination	Decline in indicator performance, including below-median scores on the Control of Corruption, Regulatory Quality, Trade Policy, and Fiscal Policy indicators; though not expressly stated by MCC, national security concerns may also have factored in[38]

The most common trigger for suspension or termination decisions has been concerns about democratic rights and practices. This was the case for all six cases of suspension or termination (or indefinite hold) of countries with active compacts, as well as the one case related to an active threshold program. For suspension/termination (or non-reselection) of countries in the compact or threshold program development phase, the rationale has been somewhat more mixed. For the five instances in which MCC publicly stated a rationale, two were related to the deterioration in democratic rights and three were related to concerns about performance on the Control of Corruption indicator. That these issues feature so prominently in MCC's

[37] Explanations reflect MCC press releases, which can be found on www.mcc.gov.

[38] In October 2007, the Government of Yemen freed the mastermind of the 2000 bombing of the USS Cole. Herrling (2007), then at CGD, posited that the sudden suspension of program signing was related to the timing of the prisoner's release.

record of suspension and termination is not surprising considering how heavily they are weighed in decisions around eligibility (both corruption and democracy are "hard hurdle" indicators).[39]

Not surprisingly, backsliding in democracy is often the catalyst for suspension/termination decisions since there is often a highly visible, concrete trigger action (e.g., a coup, an unfair election, the violent suppression of a protest) that provokes the need for MCC, as an agency specifically committed to working with well-governed countries, to react in some fashion.[40] For many other policy issues, notably corruption, there are rarely such clear actions that suggest a country's policy environment has deteriorated to an unacceptable level.

Anti-corruption policy is highly important to MCC, as reflected in the hard hurdle status of the Control of Corruption indicator in the selection process. Serious deterioration of performance in this area during compact or threshold program development or implementation might be seen as a basis for MCC to suspend or terminate the relationship. However, identifying and measuring real and significant deterioration can be difficult, especially on a timely basis. Since the corruption indicator is lagged by at least a year, is not very sensitive to changes, and measures corruption imprecisely, MCC uses additional, qualitative information to monitor signs that partner country governments are systematically trying to undermine accountability structures in a way that would enable greater abuse of power for private gain.[41] However, these kinds of actions are often incremental and sometimes invisible. In addition, few low and lower-middle income countries have perfect systems in place to discourage, detect, and punish corruption, and few countries experience a perfectly linear reform trajectory, meaning that setbacks, of some magnitude, are not unexpected and may not always, invariably trigger a response by MCC. Indeed, even when a bad corruption case places a partner country in a negative light, these high profile cases may be entirely consistent with the track record which, while highly imperfect, is still better than average.

Responding to such high profile cases (e.g., when they effect a US business interest) by suspending the MCC program would, in fact, be *inconsistent*, with the MCC model and with best practices in foreign assistance. For MCC, the relevant question is where to draw the line? Indicator performance may not be the right answer. Countries' performance on the corruption indicator may decline with no change at all in the actual anticorruption environment, or an actual decline may occur but not get picked up by the indicator for some time (or at all). In many contexts, MCC finds it challenging to identify a point when a country's anticorruption environment has become sufficiently compromised to warrant a suspension, termination, or other discontinuation of the partnership.

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[39] In addition, since MCC is legally prohibited from providing assistance to a country in which a military coup has overthrown a democratically-elected government, it is statute, as well as MCC's special focus on democratic performance, that has resulted in several coup-related terminations.

[40] Some question why MCC issues independent statements about partner countries' policy performance at all, when this is usually the role of the State Department. Because MCC is recognized as an agency that works only with relatively well governed countries, because it can suspend or terminate its programs on the grounds of policy performance, and because it strives for a certain degree of transparency in how it determines the countries with which it initiates and continues partnerships, MCC appears to make these statements either to explain why it has suspended or terminated a program with a country, to publicly pronounce that it might take such action in the future should events continue, or, where no action is taken with respect to compact funding or eligibility, to signal to stakeholders that MCC still cares about policy performance by, at a minimum, acknowledging the decline.

[41] Dunning, Karver, and Kenny (2014) document and discuss the Control of Corruption indicator's imprecision and opaque relationship to reform.

Revocation of Eligibility in the Absence of Policy Declines

MCC has sometimes invoked its model's emphasis on policy performance as a reason to curtail, end, or threaten to end a relationship with a country, even when no policy decline was evident. At times, indicators of policy performance have mattered more than policy performance itself. MCC's eligibility indicators are a useful tool for identifying relatively well-governed countries, but they are imperfect and cannot accurately capture small differences among countries or across time. In particular, a country's indicator performance may change slightly from one year to the next simply due to data noise and NOT any real change in policy performance. Applying concrete decision rules to imprecise data is arguably acceptable for initial selection into MCC eligibility because it at least provides a transparent basis for eligibility decisions. However, countries, once selected, must be reselected annually while developing a compact, and a rigid interpretation of such imprecise data does not always make sense for determining whether to continue an already-established partnership. Curtailing an ongoing relationship with a country that has had no real deterioration in policy performance just because it falls just short of meeting the scorecard criteria threatens MCC's credibility as a reasonable and rational development partner. MCC's track record on how it treats such countries is unfortunately mixed. Reselection decisions require discretion on the part of MCC and its Board, a flexibility that was intentionally and specifically built into MCC's selection process from the beginning because of the known limitations of the indicators.

In some cases, MCC has ended or truncated a relationship with countries based on factors other than their policy performance. Most notably this occurs when *indicator* performance has mattered more than *policy* performance. As noted previously, the indicators are imperfect and imprecise proxies for policy performance. While MCC's eligibility indicators are useful for distinguishing the highest performers from the lowest performers, they are imprecise and not particularly sensitive to small differences across countries.[42] Because of this, they are not really sufficiently fine-tuned to identify the marginally better performers from the marginally worse among the substantial number of ambiguously middling performing countries. Because MCC's scorecards are interpreted on a pass/fail basis, indicator performance (rather than actual qualitative differences on the ground) determines which of these middling countries can be selected.

A closer look at the Control of Corruption indicator helps explain why this process is problematic. It will also set the stage for explaining why interpreting small changes in score or rank on this indicator as grounds for cessation of country eligibility is deeply troubling.[43] As illustrated in figures 4 and 5 below, the most recent data (FY2014) show that roughly half of the countries in both the low and lower middle income country groups have Control of Corruption scores that are statistically indistinguishable from the median score at a 90% confidence level (the countries highlighted in red). In other words, roughly the middle *half* of countries ranked by their performance on the Control of Corruption indicator have scores that are *statistically* indistinguishable *both from the cutoff and from each other*.[44] Despite this, roughly half of these will be judged as having passed the indicator and therefore worthy of being rewarded for doing the right thing. The other half will be deemed to be too corrupt to be worthy of an MCC partnership.

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[42] All of the scorecard indicators have some degree of imprecision, but the error term is only explicitly calculated for four of them, Control of Corruption, Government Effectiveness, Rule of Law, and Regulatory Quality, all part of the World Bank/Brookings Institute Worldwide Governance Indicators series.

[43] The corruption indicator is also an appropriate choice both because it is often used to eliminate countries that would otherwise pass and because MCC has used it as a reason to terminate or otherwise put an end to country relationships on multiple occasions.

[44] At 90% confidence, 25 out of 56 low income countries (45%) and 15 out of 27 lower middle income countries (56%) have Control of Corruption scores that are statistically indistinguishable from the respective peer group median (the pass-fail cutoff). At 95% confidence these proportions increase to 31 out of 56 low income countries (55%) and 16 out of 27 lower middle income countries (59%).

Figure 4: Low Income Countries Ranked Performance on the Control of Corruption Indicator with 90 Percent Confidence Intervals

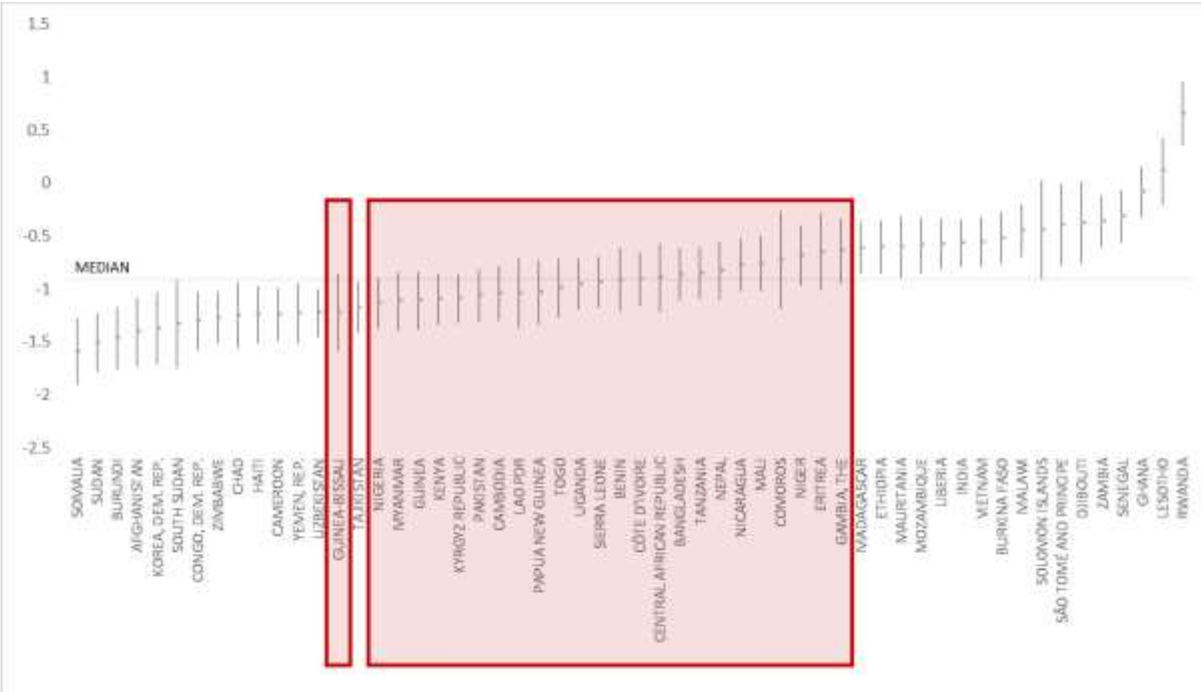
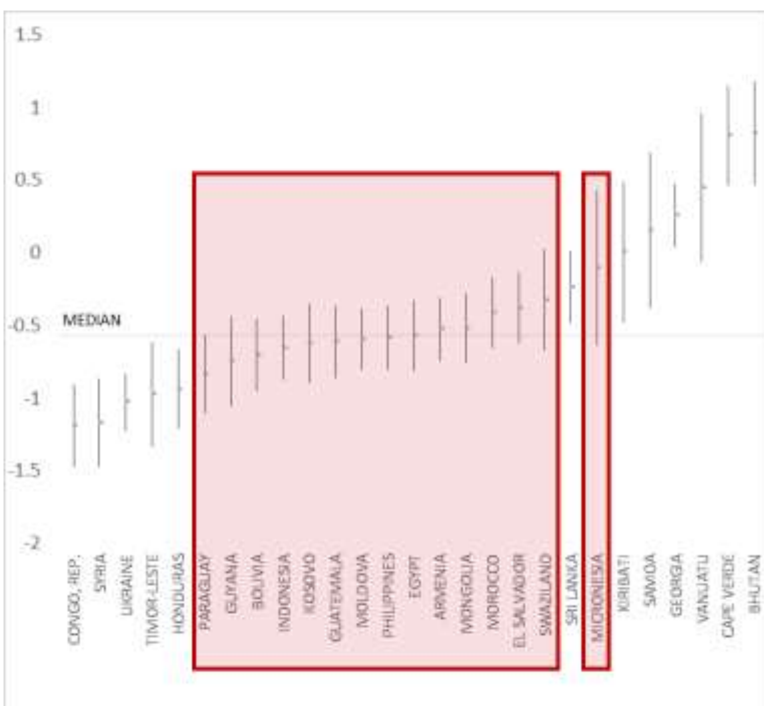


Figure 5: Lower Middle Income Countries Ranked Performance on the Control of Corruption Indicator with 90 Percent Confidence Intervals



It is plausible that *well* governed countries might do better than poorly (or even marginally-well) governed countries in terms of broad development outcomes or using foreign assistance effectively, as early MCC rhetoric suggested. However, this logic clearly cannot be extended with reasonable intellectual confidence to apply in the case of countries that are just above or just below an arbitrary threshold, whose performance is statistically indistinguishable from one another. In such contexts, it is simply impossible to make a compelling case that country data reflect any obvious and material characteristics that would determine the performance of an aid investment or contribute to differential growth rates.

This does not mean MCC should jettison its use of these indicators. Using data to identify the plausibly better policy performers represents a clear improvement over more traditional methods of making assumptions about policy performance in the absence of data, without which geopolitical considerations would be far more likely to come into play. It does mean, however, that there are almost certainly errors of inclusion and exclusion on the margins. In other words, countries may be excluded from MCC eligibility despite being, in practice, equally or even marginally better governed than those that are selected because how their policy performance is *measured* not an exact (nor exactly comparable) representation of their *true* policy performance (which is unmeasurable). However, these errors are arguably acceptable for *initial selection* into MCC eligibility. Using indicators, with all their imperfection and imprecision, at least provides a transparent basis for determining which countries are in and which are out, even if this comes down to little more than luck for the middle-performing countries.

It is, however, more troubling when MCC uses the statistically questionable pass/fail interpretation of the indicators as a reason for terminating or otherwise limiting an ongoing relationship with a country. Because of their imprecision and substantial noise-to-signal ratio, many of the scorecard indicators are not well suited for accurately monitoring *changes* in policy performance on a year-to-year basis. First, countries often change score or rank slightly from one year to the next without having had any meaningful change in policy performance. A country that scores just above the median (passing) in one year may dip just below (thus failing) the next, but, as figures 4 and 5 suggest, there is almost certainly no real change in measured performance within any reasonable confidence interval. In addition, there has probably been little, if any, change to the actual policy performance underlying the score. This is especially true in broad policy areas like anti-corruption policy or rule of law that tend to reform (or deteriorate) gradually over many years.[45] This suggests that using pass/fail performance on the eligibility indicators to end an otherwise positive ongoing partnership introduces a high level of unpredictability *on the part of MCC and the US government* that is simply inconsistent, not only with a reasonable understanding of basic statistics, but also with international norms for reasonable and rational development partnership.

In other words, using small, non-significant changes in indicator score as the basis for discontinuing relationships that have already begun reflects an indiscriminate application of a criterion – one with flexibility *built in from the outset* to accommodate the indicator's imperfect signaling powers – in a way that is counterproductive. This type of behavior creates unreasonable uncertainty and costs for developing countries that would be seen by most as contrary to the institution's founding principles. When current country partners who are acting in good faith to develop an MCC program have a change in their indicator performance such that they no longer meet the formal eligibility criteria, MCC must be able to point to a concrete policy deterioration—not just a change in indicator score—if it is to end its partnership with a country.[46]

[45] A series of years above (or below) the median add credibility to the idea that the data reflect a consistent pattern of practice that is better (or worse) than average, but data moving around the median do not reflect a basis for changing assessments every year.

[46] The same logic applies to suspension, termination, or non-reselection when a policy decline *has* identifiably occurred. MCC can point to supplemental evidence of such a decline as grounds for suspension or termination, even if it is not reflected in the indicator scores.

This, of course, requires discretion on the part of MCC and its Board, but this flexibility was intentionally built in from the beginning because of the known limitations of the indicators. As MCC was being set up, Radelet (2003) described the Bush administration's intent:

> *According to the administration's proposal, the board will be guided by the indicators, but in making final decisions it will be 'empowered to take account of data gaps, lags, trends, or other material information, including leadership, related to economic growth and poverty reduction.' This last step introduces an element of subjectivity that is probably necessary given the weaknesses in the data. However, this discretion must be used carefully and only in a limited set of circumstances to guard against too much political influence on selection.*

Allowances for discretion were also officially built into MCC's founding legislation, which says that the determination of eligibility should be based "to the maximum extent possible", not exclusively, "upon objective and quantifiable indicators…."[47] The importance of discretion is reaffirmed each year in MCC's annual Board-approved Selection Criteria and Methodology Report, the most recent of which (FY2014) says that the "indicators will be the predominant basis for determining which countries will be eligible for MCA assistance. However, the Board may exercise discretion when evaluating performance on the indicators and determining a final list of eligible countries. Where necessary, the Board also may take into account other quantitative and qualitative information…." This historic view of MCC reinforces the point that cutting off a country for a non-statistically significant dip in an indicator score is an extreme and unwarranted interpretation of the original vision of MCC's innovative use of quantitative indicators to select countries on the basis that policy performance matters.

MCC's track record on how it treats countries in compact development whose indicator performance slips despite no real change in policy performance is unfortunately mixed. Out of the universe of over 80 low and lower middle income countries, only one country – Lesotho – has passed MCC's indicator criteria every single year. This means that many MCC partner countries have, at some point during their MCC eligibility or compact implementation, not passed the indicator criteria. In the majority of those cases, this did not signal a real deterioration in policy performance.[48] MCC management and the Board are well aware of the imprecision of the indicators and, therefore, look carefully at broader patterns beyond the scope of the scorecard data. As a result, the Board has usually reselected countries that fell short on the indicators. Even in the rare occasions where countries ultimately were not reselected, most had until recently, been previously reselected for at least one year after falling short on the indicator criteria prior to losing their eligibility. In these cases, it is likely that MCC based its decision not to reselect on factors other than just indicator performance.[49]

[47] Millennium Challenge Act of 2003. Pub. L. 108-199, Div. D

[48] Reasons unrelated to a deterioration in policy performance that can cause a country to go from passing to failing an indicator include the following: (1) Methodological changes to how the indicator measures policy performance; (2) New/better data that indicate a policy environment that is less positive than previously thought (the adjustment does not necessarily reflect a decline over time and might, in fact, mask an improvement over the past year); (3) Higher medians/passing thresholds can make a country go from pass to fail, even if its own score is largely unchanged; (4) Graduation from low income to lower-middle income country status suddenly pits a country against a more competitive group, and as a result may drop in ranking, even if its own performance stays the same or even improves; (5) Small, insignificant score changes are often just statistical noise, but they can make a pass-fail difference for countries whose scores had hovered just above the median; (6) Inconsequential performance declines may reflect a real change in performance but not one of great concern (developing countries' policy performance rarely follows a smooth trajectory; there are almost always periodic setbacks).

[49] For instance, Timor-Leste, which was not reselected in December 2008, experienced political unrest in 2006, and in 2008 there were assassination attempts against the president and prime minister. Not all of these events would have been reflected in the indicators, but the Board undoubtedly was aware of and considered these facts when making its selection decision.

Figure 6: Reselection Status of Countries in Compact Development That Failed the Indicators

Reselected	Not Reselected
Cape Verde	Benin (FY2014)
Georgia*	The Gambia*† (FY2008)
Indonesia*	Sierra Leone (FY2014)
Liberia	Timor-Leste* (FY2009)
Morocco	Ukraine* (FY2009)
Mozambique*	
Namibia	
Philippines*	
Senegal	
Sri Lanka	
Timor-Leste*	
Ukraine*	

* Failed the Control of Corruption indicator
† MCC had previously suspended the Gambia's eligibility due to policy slippage in a number of areas.

There have been, however, some Board decisions in which an overly literal scorecard interpretation resulted in disregard of policy performance. In FY2014, the Board decided not to reselect Benin and Sierra Leone, both of which were in the process of developing a compact after having been selected in a prior year. MCC explained that the only reason for not reselecting the two countries was that they did not pass the Control of Corruption indicator.[50] MCC acknowledged that there was no meaningful difference between these two countries' scores and the scores of several countries that did pass, and that neither country had exhibited an actual deterioration in policy performance in the area of corruption.[51]

In addition, MCC has made various pronouncements over time that it will not sign a compact with a country unless it passes the indicator criteria the year that its compact comes up for approval. It made such a statement with respect to the Philippines in 2008 (since it had fallen short on the Control of Corruption indicator in that year) and again in 2013 with respect to four countries, Benin and Sierra Leone (which just missed meeting the Control of Corruption criteria) and Liberia and Morocco (which fell short by one indicator each in other policy areas).[52] However, tying compact approval to a country's rank on the indicators – especially an indicator like Control of Corruption – basically amounts to a rather high stakes gamble that noisy data will work out favorably in the year MCC and the country need them to.

The data worked out in this fashion for the Philippines, but that was largely luck as it did not have a score that was statistically different from its previously failing score. With respect to Benin and Sierra Leone, both solidly middle performers, it is difficult to predict on which side of the pass/fail threshold they will fall in any given year in the future, even if they have had no change in policy environment on the ground, or, indeed, even if they have made some improvements. Dunning, Karver and Kenny (2014) point out that the Control of Corruption indicator, in particular, "changes slowly over time, with an opaque relationship to reform efforts."[53]

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[50] Both countries' scores fell just below the median, the passing threshold.
[51] Remarks to this effect were made at MCC's quarterly town hall meeting on December 12, 2013. The transcript is available at www.mcc.gov.
[52] MCC Press Release. MCC Reiterates U.S. Commitment to Fight Poverty; Board Calls on Partners to Recommit to Democratic Principles; Columbia, Indonesia, Zambia now Eligible for Innovative Grants. December 11, 2008, MCC Press Release. MCC Board Selects Countries Eligible for Compacts and Threshold Programs. December 10, 2013.
[53] The timing of the indicator data can also be hugely problematic for a pronouncement that no compact will be signed until the country meets the indicator criteria. Data are lagged by a year or more, so by the time MCC or its Board make such a pronouncement (usually after the December Board meeting in which eligibility decisions are made), the die is already cast for the next year's performance; the data just have yet to be compiled. That is, by the time a country finds

The Board may view a refusal to sign a compact with a country – a country that has worked hard, for many years, at great expense to itself and MCC – on the basis of *indicator performance alone* as a way to signal how heavily MCC weighs policy performance. In fact, it signals the opposite. It disregards and discredits actual policy performance in favor of an overly-literal view of indicators that are simply not precise enough to support such rigid interpretation.

It is, however, important to acknowledge concerns that may arise if MCC were to periodically find itself reselecting during compact development countries that fall short on the scorecard criteria. Such a scenario may elicit fears that MCC's hallmark selection system would lose credibility. The difficulty, though, is that *not* reselecting this type of country (if it has not experienced an actual deterioration in policy) is also a threat—arguably a bigger threat—to the credibility of the system since the system, applied literally, yields unreasonable choices. The problem is in the stark view of how prescriptive the system must be able to be in all cases in order for it to be "credible." In fact, MCC's selection system will always be imperfect. That does not mean it should be discredited. On the whole, over its first ten years, MCC's selection system has produced a highly defensible set of relatively well-governed compact countries, and it is this broad view that confirms the system's credibility.

The difficult task for MCC is and will continue to be finding the right balance between making reasonable and responsible decisions about ongoing partnerships and signaling that it is serious about policy performance. In the past, MCC entered into a "policy improvement process" with partner countries that did not meet the indicator criteria. This involved a plan and regular reporting, but the most important gain was gauging the commitment of the countries' governments to policy reform and maintaining MCC eligibility. MCC should continue some kind of dialogue along these lines going forward.[54] In addition, MCC should continue to seek to improve the signaling power of its indicators, especially the Control of Corruption indicator. This indicator has its limitations but remains the best available option for publicly available data with adequate cross-country coverage. MCC is always seeking ways to improve its selection system, and has redoubled its efforts, along with experts in corruption and governance measurement, to think through the prospects of alternative measures.[55]

Recommendations:

MCC should:

1. **Maintain a transparent, evidence-based system for identifying relatively well governed countries with which to partner.** Just because MCC's indicator-based system has limitations does not mean it should be discredited. The indicators do an acceptable job of identifying relatively better policy performers and excluding weaker ones, though with substantial imprecision. It is always better to make decisions informed by data, especially when the limitations of the data are well known, than to make them in the absence of data.

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out that its continued partnership with MCC depends on the next year's indicator scores, there is essentially nothing that country can do to influence those scores.

[54] The challenge will be figuring out how MCC – in partnership with the country – can best provide an opportunity for a country to demonstrate concrete progress (i.e., are there appropriate specific actions that address the heart of the policy concern?). A further challenge will be for MCC to determine how the experience of their policy dialogue with a country should affect eligibility. If there is a question about a country's policy environment and the country is disinterested in engaging with MCC on ways it can demonstrate commitment and progress, then at what point will MCC walk away? Whatever that point is, MCC must be willing to do so if it serious about signaling the importance of policy performance.

[55] In April 2014, MCC and Global Integrity co-organized a meeting of roughly 40 participants who work in or closely with the field of governance measurement to explore the possibility of creating a Governance Data Alliance to improve coordination in governance data production and strengthen feedback loops between data producers and users.

2. **Better align future decisions with recognition of the inherent limitations in indicator data.** MCC management and the Board should recognize that a literal application of MCC's pass/fail rules sometimes does not make the most sense. MCC states clearly in its selection criteria and methodology report that the Board may consider additional information beyond the indicators. It should go further and explicitly specify that for a country that is currently in compact development and up for reselection in a given year, if this country fails the scorecard—even due to performance on a hard hurdle indicator—the Board does not need to determine, on this fact alone, that MCC should end the relationship.[56] Unless failure on the indicator clearly represents a positively identifiable decline in actual policy performance, MCC management and its Board should demonstrate more tolerance in its interpretation of small changes in the indicators once a country has started the compact development stage.

Congress and other MCC stakeholders should:

1. **Promote responsible use of data by MCC and its Board.** MCC and its Board care deeply about stakeholders' perceptions of their country eligibility decisions. This gives these stakeholders an important role in making sure the agency and its Board interpret the eligibility data responsibly. This is of paramount importance in the context of whether or not to reselect a country to continue compact development. Stakeholders with a strong understanding of the strengths and weaknesses of the indicators can encourage the Board to have a nuanced dialogue about policy performance and help ensure that eligibility decisions are made based on actual governance quality rather than mere data noise.

The Threshold Program

MCC reviewed its early threshold programs and found they were not well suited to achieve the program's objective. MCC re-focused the program in 2010, but some gaps in program logic remain. Furthermore, the agency will remain challenged to prove that for threshold countries that do ultimately become compact eligible that it was the threshold program that made the difference.

Background

In its original authorizing legislation, Congress explicitly gave MCC the option to "*provide assistance to a candidate country…for the purpose of assisting such country to become an eligible country*."[57] This provision became known as the threshold program, which has been a visible, but relatively small component of MCC's portfolio. Originally, per law, MCC could spend only up to ten percent of its annual appropriation on threshold programs; the FY2012 consolidated appropriations act reduced the funds available to the threshold program to no more than five percent of the annual appropriation, and this has been reapplied each year since.

The original set of threshold programs were designed to support targeted policy reforms that would help a country improve its scores on the eligibility indicators needed to pass the scorecard. The majority of these programs focused on corruption while others targeted areas like rule of law (e.g., justice sector reforms), fiscal policy, trade policy, business start-up, girls' primary education completion, and immunization rates, among others. The common thread across all of these threshold programs was the expectation that successful completion of the targeted program would be followed by improved performance on the corresponding MCC scorecard indicator.

[56] This specification in MCC's formal Selection Criteria and Methodology Report would require Board approval.
[57] Millennium Challenge Act of 2003. Pub. L. 108-199, Div. D

However, in a thorough and commendable self-assessment in 2010, MCC found that threshold programs had generally not helped countries improve their indicator scores. Essentially, the objective of the threshold program was technically unrealistic. Many eligibility indicators tend to be very broad in scope (e.g. "control of corruption") and are not appropriate for capturing the progress of more narrow programmatic interventions. In addition, there were few independent evaluations conducted for the first phase of the threshold program (there are four completed evaluations out of 24 programs). [58] Of those, the results were mostly poor.[59]

In response, MCC made a number of changes to the threshold program. It maintained a focus on policy reforms, but in a rather different way. The new version of the threshold program, launched in 2011, is now expected to help a country become compact eligible by providing insights into the willingness and ability of the partner government to undertake substantial policy and institutional reforms. [60] This is meant to inform MCC about the "opportunity to reduce poverty and generate economic growth in [a] country" (a secondary and less visible, though important, criterion for eligibility outlined in MCC's legislation). Put differently, the threshold program is now akin to a trial run for a compact. In fact, threshold programs now contain many of the same procedures and requirements as a compact, including a constraints analysis to identify bottlenecks limiting investment and growth and to inform what the program will fund, and, in some cases, the use of an in-country counterpart ("accountable entity") established to contribute to implementation.[61]

Questions about the New Model Threshold Program

While this second-generation threshold program arguably fits within the MCC model's focus on policy performance, there are some fundamental questions about how it will work. In particular:

- **How much will the threshold program experience really inform MCC about a future compact experience?** The threshold program's ability to provide evidence of a country's reform commitment is limited in two important ways. First, a country's "government" is made up of a number of different entities, each of which has its own political economy dynamics and constraints. So unless the threshold program targets the same policy areas as a future compact, the threshold program experience may not be indicative of future policy and institutional performance in a compact.[62] Even

[58] An early strategy to contract an independent evaluation of every threshold program was eventually set aside as a result of two factors. First, one-off activities were seen as having very low learning potential for the institution, especially given that the information available for these programs ruled out any rigorous impact evaluation with a statistically measured counterfactual. Second, the release of the initial batch of evaluations referenced in the text coincided with an institutional decision to fundamentally change the institution's strategy for threshold programs. Consequently, any findings – positive or negative – would have no material effect on future threshold programs.

[59] The independent evaluations of the early threshold programs in Indonesia, Malawi, and Zambia, all available on MCC's website, provide documentation of poor planning by MCC and poor implementation and management by USAID. The fact that MCC had already decided to change its model made it easier for MCC to accept and publish the findings. Because threshold programs were not governed by the same focus on results, governance programs were designed and implemented with little thought to the metrics for impact and cost-effectiveness found in MCC's five-year compacts.

[60] According to MCC's Report on the Selection of Eligible Countries for Fiscal Year 2013, the new model will allow countries to "*demonstrate the capacity and political will to make difficult policy reforms in partnership with MCC. This will contribute directly to the board's understanding of a country's capacity to undertake the type of policy reforms typically required to enable a compact investment to have maximum sustainable impact*."

[61] In the original model, almost all threshold programs were implemented by USAID. MCC seeks to expand the choices for implementation modalities with the new threshold program, though USAID is expected to remain an option.

[62] By illustration, a threshold program in the customs sector will provide little or no indication of the same country's willingness and ability to tackle reforms critical for a future compact investment in another sector, such as water and sanitation. It is certainly possible that a constraints analysis completed for a future compact would identify constraints to growth similar to those identified in the threshold program constraints analysis, but it is not guaranteed. In fact, countries that are developing second compacts often find they are focusing on different sectors than the first compact due to changes in the binding constraints to growth.

within a single sector, the ability to get political traction on different pieces of a reform can vary considerably. Second, political will or commitment to certain reforms may change over time, either within or across administrations. By illustration, it would take at least ten years to complete the process of threshold program development, threshold program implementation, compact eligibility and development, and compact implementation. During this time a change in leadership at the head-of-state and/or ministerial level is likely. Simply put, policy performance during the first three years of an MCC relationship presents an unreliable predictor of policy performance five or more years later during the middle years of the compact.

- **Why is understanding willingness/ability to reform more necessary for just these countries?** To the extent that the threshold program can provide MCC meaningful information about a country's commitment and ability to undertake policy reforms in partnership with MCC (as it would likely have to do as part of a compact agreement), it is unclear why this kind of information is considered a precondition for eligibility only for the small set of countries that are selected for the threshold program. MCC says that the threshold program is for countries that come close to meeting (or perhaps just meet) the indicator criteria, for which there is also an outstanding question about how well a partnership would work. However, there is some level of uncertainty in *all* compact partnerships about how well the partnership will work. In fact, anecdotal evidence suggests that compact progress even in countries with strong scorecard performance has sometimes been challenged or slowed due to difficulty gaining traction with the partner government on its agreed upon policy reform contributions. Given this tenuous link between scorecard performance and commitment to timely implementation of compact-related reforms, it is unclear why, for most of the picks for the threshold program to date, just these countries on the margins of passing the scorecard are additionally required to pre-demonstrate their commitment to compact-style policy reforms before securing compact eligibility. If MCC considers this an important thing to know about any potential partner country and acknowledges that it is not well captured by the scorecard, it makes little sense to require demonstration of this commitment from just a small handful of countries.
- **How will MCC prove success?** While the threshold program may support some useful policy reforms and it may give MCC some notion of a government's willingness to undertake policy reform-type programs, meeting the indicator criteria is still of primary importance for consideration for compact eligibility. If any threshold program countries end up passing the scorecard and are subsequently selected as eligible, the only way external stakeholders can know if the threshold program actually helped the country become eligible—that is, the country would *not* have been selected once it passed the indicators had it *not* participated in the threshold program—is to take MCC's word for it.[63] That is not very satisfying for stakeholders who need convincing that the program is not simply a relatively low cost way to expand the MCC pipeline or accommodate political pressures to partner with not-quite-compact-caliber countries while maintaining the integrity of MCC's selection process.

Despite these questions, the threshold program clearly is consistent with MCC's policy performance precept, even if it is no longer seen as an explicit effort to improve indicator scores. In many ways, the new model reflects a more logical interpretation of the idea that policies matter – and some specific policies matter most of all – for a donor's investment to contribute to poverty reduction and economic growth. While there is substantial literature that supports the link between the policy areas that the scorecard seeks to measure and

[63] Of the current set of three eligible countries (Nepal, Honduras, and Guatemala), only Nepal may be a relatively easy case to prove whether threshold program performance makes a difference for eligibility, since it already met the indicator criteria when it was selected as a threshold country. This indicates that the binding constraint to eligibility really was uncertainty on the part of MCC as to how willing and able the Government of Nepal would be to undertake difficult policy reforms in partnership with MCC.

poverty reduction and economic growth, it is usually specific policies in the sector in which an investment will take place that are more relevant to the success and prospects for sustainability of that investment.[64]

The Threshold Program as Political Buffer

Though the legislated purpose of the threshold program is to help countries become eligible for a compact, a close look at MCC's record of threshold-eligible countries suggests it has also, on a few occasions, been used as a political buffer, a way for MCC to accommodate pressure from its Board (especially the State Department) to engage a diplomatically strategic country that does not meet MCC governance standards. For instance, as described in the first section, the decisions to select the Kyrgyz Republic, Tunisia, and Honduras as eligible for threshold programs were inconsistent with the spirit of MCC's formal model.

Having the option of the threshold program, whose eligibility standards are slightly less well-defined (a country just has to be "close" to passing the scorecard criteria), may well have helped prevent MCC from using its more visible, more resource-intensive flagship compact program to advance diplomatic objectives in countries that did not meet the criteria for eligibility. Although this is not the intended purpose of the threshold program, it may have been a useful outcome. On the other hand, it is possible that without the option of the relatively low-cost, less-visible threshold program with more ambiguous eligibility requirements, MCC could have had a stronger basis to push back on selecting strategic countries that do not quite fit the right profile for an MCC country. It could be harder for members of the Board to justify newly selecting a country for compact eligibility that does not meet the indicator criteria, even if that country is politically important (*especially* if that country is politically important) since such a decision would inevitably draw criticism about the politicization of MCC eligibility.

Recommendations

MCC should:

1. **Better define the rationale of the new threshold program.** MCC should explain in more detail how it believes the experience of the threshold program will help a country become eligible, how well it will really inform whether MCC is likely to get traction on compact-related policy reforms several years down the line, and why—if valuable information is possible—this is only important to know for a few countries that are "close" to meeting the indicator criteria.
2. **Be much clearer about how it will prove threshold program success.** MCC is a results-focused agency. The old model of the threshold program was dismantled largely because MCC was unable to convincingly prove that it was helping countries achieve compact eligibility. For the new model to be viable, MCC must be able to clearly demonstrate how it achieves its goal of helping countries become compact eligible.
3. **In the absence of a clear rationale or demonstrable success, eliminate the threshold program.** The threshold program accounts for a small portion of MCC's budget, but, in the absence of a clear rationale or compelling proof of program success, these funds could be better spent on compact activities that, in general, have a much more clearly demonstrated link between action and intended impact.

[64] MCC's Guide to the Indicators and the Selection Process for Fiscal Year 2014 provides a review of the literature on the relationship between the policy areas measured by the indicators and poverty reduction and economic growth.

How is MCC's Focus on Policy Performance Different from other US Foreign Assistance?

Other donors, including other US foreign aid agencies, use some kind of governance or policy criteria to guide their investments, but MCC is the only donor that uses a largely transparent system based on independent, quantitative criteria of policy performance to determine which countries it will fund.

MCC is not the only donor, or even the only US government foreign assistance agency, to consider policy performance when making decisions about where to invest. For instance, every multilateral development bank includes institutional and policy performance as a major factor in determining how a fixed volume of available assistance will be allocated. However, these approaches assume that all relatively poor countries will receive some level of assistance. Moreover, while country scores are published, the underlying assessment process is internal and the methodology is often opaque. Currently, MCC remains the only donor to use a largely transparent set of independently produced, quantitative criteria to determine where it will work.

Within the US government, the Partnership for Growth (PFG), an initiative that seeks to accelerate economic growth in select countries, used policy performance—including MCC scorecard performance—as part of the criteria to identify focus countries.[65] However, the US government has not published the other criteria used to assess countries, nor how it weighed performance on the MCC criteria. As part of the PFG approach, all government agencies, including USAID and the State Department, were to reconsider strategies that shaped the magnitude and pattern of resources delivered to PFG countries. PFG was always intended to have a greater focus on non-financial forms of engagement, however, so it is not surprising that PFG partner countries have not seen significant new resources.

The MCC approach to country selectivity is not necessarily appropriate for the range of other US government development efforts. For example, humanitarian relief, refugee assistance, and post-conflict reconstruction are usually concentrated in more fragile policy environments. Beyond these activities, however, it may make sense to apply more of an MCC-type model for portions of the foreign assistance budget, particularly in the currently constrained budgetary environment. Indeed, the 2010 Presidential Policy Directive (PPD) for Global Development Policy stressed that the US should be more selective, focusing its resources in "select countries and sub-regions where the conditions are right to sustain progress."[66] Aside from the PFG, which has not discernibly influenced new resource allocation decisions, it is unclear how the US government has implemented this recommendation. Clearly USAID could attempt to more systematically incorporate policy performance criteria into its country allocation decisions, but legislative earmarks and non-developmental objectives will remain material barriers to significant reforms. To the extent, then, that the US government believes it important to visibly target a portion of its foreign assistance dollars to well-governed countries—out of the belief that doing so will create an incentive for countries to improve their policy performance, that well-governed countries should be rewarded, or that some types of aid may be more effective in better-governed environments—then MCC and its approach to policy performance remain important tools for the US' global development efforts.[67]

[65] The State Department's Fact Sheet on PFG (November 29, 2011) lists the criteria for inclusion in PFG as: "performance on the Millennium Challenge Corporation's selection criteria, a track record of partnering with the United States, policy performance, and potential for continued economic growth, among other criteria."

[66] From the White House's September 22, 2010 Fact Sheet on US Global Development Policy

[67] The PPD suggests that the reasons for targeting aid toward well-governed countries that were elaborated as part of MCC's founding still resonated years after the agency's founding. For instance, the document says, "Where leaders govern responsibly, set in place good policies, and make investments conducive to development, sustainable outcomes can be achieved. Where those conditions are absent, it is difficult to engineer sustained progress, no matter how good our intentions or the extent of our engagement. While US policies and investments cannot substitute for the actions of other governments, we will work with other governments and nongovernmental partners and with international institutions to create incentives for countries to make these choices by rewarding sound policies with long-term commitments of resources; enhanced trade and investment ties; bilateral and multilateral engagement; targeted investments designed to build government capacity and to bolster key sectors of developing economies, such as agriculture and health systems; and through the provision of enhanced security."

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