

# CRS Report for Congress

## Millennium Challenge Account

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Curt Tarnoff  
Specialist in Foreign Affairs  
Foreign Affairs, Defense, and Trade Division



Prepared for Members and  
Committees of Congress

# Millennium Challenge Account

## Summary

In a speech on March 14, 2002, President Bush outlined a proposal for a major new U.S. foreign aid initiative. The Millennium Challenge Account (MCA) is managed by the Millennium Challenge Corporation (MCC) and provides assistance, through a competitive selection process, to developing nations that are pursuing political and economic reforms in three areas: ruling justly, investing in people, and fostering economic freedom.

The MCC differs in several respects from past and current U.S. aid practices:

- the competitive process that rewards countries for past and current actions measured by 17 objective performance indicators;
- the pledge to segregate the funds from U.S. strategic foreign policy objectives that often strongly influence where U.S. aid is spent; and
- the requirement to solicit program proposals developed solely by qualifying countries with broad-based civil society involvement.

As announced by the President in March 2002, the initial plan had been to fund the MCC annually at \$5 billion by FY2006, but this figure has not yet been reached. The Administration has sought a combined \$12.8 billion for the MCA program, FY2004-FY2008, while Congress appropriated \$7.5 billion, or less than two-thirds of the total sought. In the FY2008 Consolidated Appropriations Act (H.R. 2764, P.L. 110-161), Congress provided \$1.54 billion for the MCA, about half of the Administration request. For the MCA in FY2009, the Administration has requested \$2.225 billion, a 44% increase over the previous year's appropriation.

Congress authorized the MCC in P.L. 108-199 (January 23, 2004). Since that time, the MCC's Board of Directors has selected 27 eligible countries during the period from FY2004 through FY2008 (another, The Gambia, was suspended in 2006) and approved 16 Compacts with Madagascar (April 2005), Honduras (June 2005), Cape Verde (July 2005), Nicaragua (July 2005), Georgia (September 2005), Benin (February 2006), Vanuatu (March 2006), Armenia (March 2006), Ghana (August 2006), Mali (November 2006), El Salvador (November 2006), Mozambique (July 2007), Lesotho (July 2007), Morocco (August 2007), Mongolia (September 2007), and Tanzania (September 2007).

MCA implementation matters continue to unfold, including the relationship of MCA and USAID, sectors chosen, and the impact of rising costs on country programs. A growing question raised by some Members of Congress concerns the level of funding to support MCC programs. Some fear that insufficient funds might force the MCC to reduce the number of recipients or the size of the grants. Others, however, support reductions in MCC budget requests, believing that the slower-than-anticipated pace of Compact agreements means that the Corporation has enough resources.

This report will be updated as events unfold.

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## Most Recent Developments

On May 22, 2008, the Senate approved its version of H.R. 2642, the FY2008 and FY2009 supplemental, including two committee amendments that would rescind \$525 million from the MCA. The funds would be used to provide disaster aid to Burma (\$225 million) and economic and military aid to Jordan (\$300 million). In effect, one planned Compact — likely that of Burkina Faso or Namibia — would have to be postponed if the Senate provisions are adopted in conference with the House.

On March 11, 2008, the MCC Board added the Philippines to the list of countries eligible for Compact funding. It joins 24 countries previously selected in December 2007, including Malawi, the only other new country chosen in FY2008. The Board also added Mauritania to the list of countries eligible for Threshold Program funds.

On February 4, 2008, the Administration requested \$2.225 billion for the MCA in its FY2009 budget, a 44% increase over the FY2008 level.

On December 26, 2007, the FY2008 Consolidated Appropriations Act (P.L. 110-161, H.R. 2764) was signed into law. It provides \$1.544 billion (after a .81% rescission) for the MCA, \$1.5 billion less than the Administration request.

## Overview

In a speech on March 14, 2002, President Bush outlined a proposal for a new program that would represent a fundamental change in the way the United States invests and delivers economic assistance. The resulting Millennium Challenge Account (MCA), managed by a new Millennium Challenge Corporation (MCC), provides assistance, through a competitive selection process, to developing nations that are pursuing political and economic reforms in three areas:

- Ruling justly — promoting good governance, fighting corruption, respecting human rights, and adhering to the rule of law.
- Investing in people — providing adequate health care, education, and other opportunities promoting an educated and healthy population.
- Fostering enterprise and entrepreneurship — promoting open markets and sustainable budgets.

As the program evolves, the 110<sup>th</sup> Congress will continue to debate MCA funding issues and conduct oversight hearings on operations of the Corporation.

## MCA Background<sup>1</sup>

The MCA is based on the premise that economic development succeeds best where it is linked to free market economic and democratic principles and policies, and where governments are committed to implementing reform measures in order to achieve such goals. The MCA concept differs in several fundamental respects from past and current U.S. aid practices:

- the size of the original \$5 billion commitment;
- the competitive process that will reward countries for past actions measured by 17 objective performance indicators;
- the pledge to segregate the funds from U.S. strategic foreign policy objectives that often strongly influence where U.S. aid is spent; and
- the requirement to solicit program proposals developed solely by qualifying countries with broad-based civil society involvement.

The new initiative, which Congress authorized in January 2004 (Division D of P.L. 108-199), was scheduled to phase in over a three-year period, beginning in FY2004. During the first year, MCA participation was limited to the 74 poorest nations with per capita incomes below \$1,415 and that were eligible to borrow from the World Bank's International Development Association. The list expanded in FY2005 to include all low-income countries with a per capita income below \$1,465 (adding another 13 nations). Beginning in FY2006 and beyond, all low- and lower-middle-income countries (with per capita incomes between \$1,735 and \$3,595 in FY2008) compete for MCC resources (a total of 95 countries in FY2008). However, lower-middle-income countries may receive only a quarter of MCA assistance in any year.

Country selection is based largely, but not exclusively, on the nation's record measured by 17 performance indicators related to the three categories, or "baskets," of good governance, economic freedom, and investing in people. Countries that score above the median on half of the indicators in each of the three areas qualify. Emphasizing the importance of fighting corruption, the indicator for corruption is a "pass/fail" test: should a country fall below the median on the corruption indicator, it will be disqualified from consideration unless other, more recent trends suggest otherwise. (See **Table 4** below for a complete list of the 17 performance indicators.) Administration officials, since announcing the MCA initiative in 2002, have said that the selection process would be guided by, but not necessarily bound to the outcomes of the performance indicators. Missing or old data, general trends, and recent steps taken by governments might also be taken into account when annual decisions are made.

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<sup>1</sup> For a more in-depth discussion of the original MCA proposal and issues debated by Congress in 2003, see CRS Report RL31687, *The Millennium Challenge Account: Congressional Consideration of a New Foreign Aid Initiative*, by Larry Nowels.

Eligibility to receive MCA assistance, however, does not necessarily result in an aid grant. Once selected, countries are required to submit program proposals — referred to as MCA Compacts — that have been developed through a broad-based, national discussion that includes input from civil society. The focus of program submissions may vary among countries in size, purpose, and degree of specificity, and are evaluated by the Corporation for, among other things, how well the Compact supports a nation's economic growth and poverty reduction goals. Only those Compacts that meet the MCA criteria will be funded. It is expected that successful Compacts will support programs lasting three to five years, providing a level of resources roughly equivalent to the largest providers of assistance in the country. In most cases, this will likely result in a significant increase of U.S. economic assistance to MCA participant countries.

To manage the new initiative, the Administration proposed and Congress authorized the creation of a Millennium Challenge Corporation (MCC), an independent government entity separate from the Departments of State and the Treasury and from the U.S. Agency for International Development (USAID). The MCC plans for an eventual staff of about 300. It is led by a CEO confirmed by the Senate. The current CEO is Ambassador John Danilovich.<sup>2</sup> A Board of Directors oversees operations of the MCC and makes the country selections. It is chaired by the Secretary of State and composed of the Secretary of the Treasury, the USAID Administrator, the U.S. Trade Representative, the Corporation's CEO, and four individuals from the private sector drawn from lists of proposed nominees submitted by Congressional leaders.<sup>3</sup>

The decision to house the MCA in a new organization was one of the most debated issues during early congressional deliberations of the President's foreign aid initiative. The Administration argued that because the MCA represents a new concept in aid delivery, it should have a "fresh" organizational structure, unencumbered by bureaucratic authorities and regulations that would interfere in effective management. Critics, however, contended that if the MCA was placed outside the formal U.S. government foreign aid structure, it would lead to further fragmentation of policy development and consistency. Some believed that USAID, the principal U.S. aid agency, should manage the MCA, while others said that the MCA should reside in the State Department where more U.S. foreign policy entities have been integrated in recent years. At least, some argued, the USAID Administrator should be a member of the MCC Board, which had not been proposed in the initial Administration request.

It appears that the MCC's status will remain unchanged under Secretary Rice's realignment of foreign aid authorities, announced on January 19, 2006. Henrietta Holsman Fore, the USAID Administrator, also serves concurrently in the newly

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<sup>2</sup> Replacing Paul Applegarth who resigned on August 8, 2005.

<sup>3</sup> The private sector Board members are Alan Patricof, co-founder of a venture capital corporation; Lorne Craner, President of the International Republican Institute; former Senate Majority Leader William Frist; and Kenneth Hackett, President and CEO of Catholic Relief Services. The latter is a reappointment, permitted a two-year term; the others are serving their first three-year terms.

created State Department position of Director of Foreign Assistance. While gaining policy and budget authority over nearly all USAID and State Department foreign aid programs, the Director plays a more limited role in other agency activities, by developing an overall U.S. government development strategy and providing “guidance” to foreign aid programs delivered through other agencies like the MCC.

## MCC Implementation

From the time the MCC Board of Directors held its initial meeting to establish the program and agree to Corporation by-laws on February 2, 2004, procedures and policies have continued to evolve. Program implementation moves chronologically through a number of steps: candidate countries are identified, criteria are formulated, Compact and threshold-eligible countries are selected, programs are developed and proposed, and those approved are funded and carried out. Elements in this process are discussed below.

### Selection of Candidate Countries

The selection of initial candidate countries is fairly straightforward and based on the authorizing statute. Countries must fall into specific economic categories determined by their per capita income status (as defined and ranked by the World Bank). In the first two years of the program, only low-income countries were considered, and, in the first year only, these had to be International Development Association-eligible borrowers (a World Bank loan window). Beginning in FY2006, low-income countries were joined by lower-middle-income countries. Currently, low-income countries are defined as those with a per capita income of \$1,735 and below; lower-middle-income countries are between \$1,735 and \$3,595.

In addition to the income ceiling, countries may be candidates only if they are not statutorily prohibited from receiving U.S. economic assistance. In FY2008, 13 countries were excluded for this reason. Most had been barred in prior years as well.<sup>4</sup>

On August 24, 2007, the MCC transmitted to Congress its annual notification of candidate countries, listing 67 low-income countries and 28 lower-middle-income countries (See **Table 3A** and **Table 3B**). There were two new entries to the low-income candidates: Somalia and Cambodia. Previously, Somalia had been barred by the Brook Amendment prohibiting aid to countries defaulting on debt to the U.S. government. Cambodia was prohibited from receiving most aid under the annual Foreign Operations appropriations; relations with that country have since improved.

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<sup>4</sup> Various types of aid restrictions applied to these countries. For several — Sudan, Cote d’Ivoire, Fiji, and Thailand — U.S. aid was blocked because an elected head of government had been deposed by a military coup. For Uzbekistan, legislation banned FY2007 assistance to the central government. Aid restrictions imposed on nations not cooperating in counter-narcotics efforts (Burma), that are on the terrorist list (Sudan, Syria, Cuba, North Korea, Iran), or in arrears on debt owed the United States (Zimbabwe) also applied. Notwithstanding these restrictions, each country remained eligible for humanitarian assistance from the United States.

Angola, Armenia, Azerbaijan, and Ukraine have moved from low-income to lower-middle-income status. Five previously lower-middle-income countries are no longer candidates: one, Fiji, cannot be considered because of a military coup; the others have graduated to middle-income status.

## Country Selection Criteria and Methodology

The choice of criteria on which to base the eligibility of countries for threshold and Compact programs is one of the most important elements in MCC operations (See **Table 4** for Performance Indicators). They are a key statement of MCC development priorities and ultimately determine which countries will receive U.S. assistance. Perhaps of equal significance, the current indicators themselves have become prominent objectives of some developing countries in what Board CEO Danilovich has called the “MCC effect.”<sup>5</sup> Countries seeking eligibility are moving on their own to enact reforms and take measures that would enable them to meet MCC criteria. The criteria and the methodology for applying them have evolved over time.

Pursuant to reporting requirements set in the MCC legislation, each year the Corporation sends to Congress an overview of the criteria and methodology that would be used to determine the eligibility of the candidate countries in that fiscal year. The criteria have been altered and refined, sometimes dramatically, over time.

While the MCC legislative authorities broadly match criteria proposed by the Administration, lawmakers included four additional matters on which to evaluate a country’s performance. These relate to the degree to which a country:

- recognizes the rights of people with disabilities;
- respects worker rights;
- supports a sustainable management of natural resources; and
- makes social investments, especially in women and girls.

For each of these, the MCC has sought to use supplemental data and qualitative information to inform its decisions on Compact eligibility. The latter two factors have led to the development of new indicators.

With regard to the requirement added by Congress regarding social investments in women and girls, at first the MCC reported it would draw on girls’ primary enrollment rates to supplement the four social investment performance indicators. But in FY2005, an indicator measuring girls’ primary education completion rates replaced a broader measure used in FY2004 that did not disaggregate primary education graduation by gender.

Beginning with the FY2005 selection process, the MCC lowered the inflation rate threshold from 20% to 15%, making it somewhat more difficult to pass this test (only 6 of the 63 candidate countries failed this test for FY2004). For FY2006, the Corporation added a new indicator — the Cost of Starting a Business — that replaced

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<sup>5</sup> MCC Public Outreach Meeting, February 15, 2007.



the Country Credit Rating, a measure that was used in the FY2004 and FY2005 evaluation process. The Corporation believed that not only did the new indicator have a strong correlation with economic growth, but that it was a measurement that might encourage governments to take action in order to improve their scores. Since the initial use of the indicator Days to Start a Business, MCA candidate countries had introduced many business start-up reforms, the results of which were reflected in a lowered median for this category. MCC officials hoped that adding an indicator for the Cost of Starting a Business would stimulate additional policy improvements. They believed that the Country Credit Rating indicator was not as well linked to policy reforms and that it had a greater income bias than other MCC indicators.

Efforts to develop a measurement to assess a country's commitment to policies that promote sustainable management of natural resources as required by Congress led to the adoption of two new indicators, first used as supplemental information in determining FY2007 MCA eligibility and then integrated with all the other indicators beginning with the FY2008 eligibility process. The Natural Resources Management index is a composite of indicators: whether the country is protecting at least 10% of its biomes, the percentage of population with access to sanitation and clean water, and child mortality levels. It has been placed in the Investing in People basket, raising the number of those indicators to five. The Land Rights and Access index looks at whether land tenure is secure and access to land is equitable, and the number of days and cost of registering property. It has been placed in the Economic Freedom basket. That basket remains at six indicators, because, beginning in FY2008, the MCC collapsed the Days to Start a Business and Cost of Starting a Business indicators into one Business Start-Up indicator.

In addition to adding or refining indicators, the Corporation has also modified its principal that, in selected cases, countries must score *above* the median in order to pass a hurdle, with a rule that scores at the median will represent a passing grade. This comes into play especially for those indicators (civil liberties, political rights, and trade policy) where performance is measured on a relatively narrow scale of 1-5 or 1-7. A number of countries fall exactly on the median of these indicators and the methodology change allowed the MCC to make a more refined determination of whether a country passes or fails these hurdles.

In December 2006, Ambassador Danilovich announced that the MCC would apply gender analysis to all aspects of the MCC program, including country selection and Compact development and implementation.

## Selecting Eligible Countries

Shortly after release of the performance criteria, the MCC publishes a scorecard, showing where each candidate country's performance falls in relation to the other candidate countries in its peer group (i.e., lower income countries "compete" with other lower income countries and lower-middle income countries with other lower-middle income countries). Some time later, the MCC Board meets to select its list of countries eligible to apply for Compact assistance.

A review of the history of MCC selections suggests that the Board is guided by, but not entirely bound to, the outcome of the performance indicator review process;

Board members can apply discretion in their selection. Performance trends, missing or old data, and recent policy actions might come into play during selection deliberations.

For example, in its first year, FY2004, the MCC selected 16 countries. The selection reflected decisions that both strictly followed the performance indicator outcomes and applied Board discretion to take into account other factors. Ten of the countries complied with the stated criteria: performing above the median in relation to their peers on at least half of the indicators in each of the three policy “baskets” and performing above the median on corruption. The Board also examined whether a country performed substantially below average on any single indicator and whether their selection was supported by supplemental information. Each of the 10 countries also passed these additional tests.

For 10 other countries, however, some discretion was applied by the Board. In three cases, countries which met the criteria but fell significantly below average on one indicator were still selected by the Board due to recent policy changes or positive trend lines. Cape Verde, for example, scored poorly on the Trade Policy indicator, but the Board took into account the country’s progress towards joining the World Trade Organization and implementing a value added tax that will reduce reliance on import tariffs. Lesotho did not score well on the measurement for Days to Start a Business. The MCC Board, however, took note of Lesotho’s creation of a central office to facilitate new business formation and saw positive performance on other factors related to business start-ups. Sri Lanka scored far below the median on Fiscal Policy, but the most recent trends suggested that the government was making progress in reducing its budget deficit.

For three other countries — Bolivia, Georgia, and Mozambique — the Board deviated from a strict application of the selection criteria because of evidence that the governments were taking corrective actions in the deficient areas. Bolivia fell at the median (as opposed to above the median) on the corruption indicator, something that would eliminate it from consideration. The Board, however, noted that President Mesa, who took office in October 2003, had created a cabinet position to coordinate anti-corruption activities and an office to investigate police corruption. Georgia, with a newly elected government that had created an anti-corruption bureau and taken other steps to fight corruption, was also selected despite scoring below the median on corruption and three other “ruling justly” indicators. Mozambique, which failed on corruption and each of the four “investing in people” indicators, was chosen based on supplemental data that was more current than information available from the primary data sources. This evidence, the Board felt, demonstrated Mozambique’s commitment to fighting corruption and improving its performance on health and education.

On the other hand, the MCC Board chose not to select four countries that technically met the performance criteria but fell substantially below the median on one or more indicator. In each of these cases, the Board did not believe that the government was taking any action to improve its performance. Although Bhutan, Mauritania, and Vietnam passed the corruption hurdle and half of the “ruling justly” indicators, they scored very low on the measurements for Political Rights and Civil Liberties, and in Vietnam’s case, on the Voice and Accountability indicator. A fourth

country — Guyana — was also not selected despite passing the necessary hurdles. It scored particularly low on the Fiscal Policy measurement.<sup>6</sup>

As the candidate pool was enlarged in succeeding years while funding levels failed to meet expectations, the Board has become increasingly more selective. Many outside the MCC support the approach of keeping the number of new participants to a few so that future Compacts can be larger and emphasize “transformational” development opportunities as the MCA program originally envisioned.

For FY2005, the Board did not select 10 countries that met the criteria, including Bhutan, Vietnam, Guyana, Burkina Faso, China, Djibouti, Egypt, Nepal, the Philippines, and Swaziland. The Corporation offered little explanation as to why these countries were not chosen.<sup>7</sup> It appeared, however, that scoring “substantially below” — perhaps in the lowest 25<sup>th</sup> percentile — had become a de-facto criteria for exclusion. For example, the Corporation’s CEO Paul Applegarth commented that the Philippines, a country that passed 13 of the 16 indicators, did not qualify because Manilla scored “substantially below” the median on tests for health expenditures and fiscal policy, and that more recent trends indicated the fiscal policy situation was deteriorating further.<sup>8</sup> Each of the other nine nations that met the minimum qualifications but were not selected also had one score in the 25<sup>th</sup> percentile, although the Corporation has not commented on whether this was the reason for not choosing them.

Another Board departure in the FY2005 selection process was to avoid using its discretionary authority to qualify countries that did not meet the minimum performance indicators. For FY2004, the Board chose three nations — Bolivia, Georgia, and Mozambique — that did not pass the so-called “hard-hurdle” of corruption. The latter two again qualified despite falling below the median on corruption, while Bolivia did not require an exemption after the median dropped below its score with the addition of new countries. For FY2005, five nations — Malawi, Moldova, Paraguay, Tanzania, and Ukraine — passed the required number of performance indicators, except corruption. Although Malawi, Paraguay, and Tanzania are Threshold Countries, none of the five were chosen for full MCA status.

In FY2006, the Board did not choose eight countries in the low-income group that qualified and did not use its discretionary powers to select any new nations that

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<sup>6</sup> For a complete statement regarding the Board’s rationale, see *Report on the Selection of MCA Eligible Countries for FY2004*, found at [<http://www.mcc.gov>], “Congressional Reports.”

<sup>7</sup> The MCC’s authorizing legislation (section 608(d)) requires the Corporation’s CEO to provide justification to Congress regarding only those countries declared as eligible for MCA assistance and for those selected for Compact negotiation. Otherwise, there is no statutory requirement for the MCC to comment on its decision-making process, including the rationale for not selecting specific countries.

<sup>8</sup> Comments by Paul Applegarth at a State Department Foreign Press Center Briefing, November 9, 2004.

failed to meet the minimum requirements.<sup>9</sup> Bhutan, China, and Vietnam passed enough hurdles but did not qualify, as was the case the past two years, based on very low scores on political rights and civil liberties. Kiribati, the Philippines, and India were not selected most likely because some of their scores were substantially below the median, which has become a marker used by the Board previously. India also presents a challenging case for the Board in that, despite qualifying, it is a country with a significantly large poor population which would require a sizable MCA Compact in order to produce a reasonable degree of impact on poverty reduction. It is also a nation with the means to attract capital and investment from other sources. Egypt, also not selected, falls into a somewhat different category as the second largest recipient of annual U.S. assistance based on a strategic rationale. The reason for not selecting Uganda, despite having passed 12 of the 16 indicators and not falling significantly below the median on the other 4, is less obvious.

In its first year of choosing among lower-middle-income countries, the Board's approach was less clear. A number of analysts had argued that especially given the less-than-anticipated budget available to the MCC, the Board should refrain from selecting any lower-middle-income countries (LMICs), at least in the FY2006 round.<sup>10</sup> Of the eight LMICs (out of 32 total) that passed sufficient performance hurdles, the Board chose two to participate in FY2006. In addition, the Board also selected Cape Verde, a country that passed only two of the six economic performance indicators and therefore, did not technically qualify.<sup>11</sup> It appears, however, that the Board could have decided to select none of the lower-middle-income nations by using criteria it had applied consistently in the two previous rounds. Moreover, it was not clear why the Board chose the two that did qualify and excluded others.

All eight LMICs that passed the performance indicator test fell significantly below the median on at least one of the indicators. El Salvador and Namibia, the two that were selected, both had low scores on fiscal policy. El Salvador also scored well below the median on the costs of starting a business, while Namibia also did poorly on days to start a business and immunization rates. The other six that were not chosen — Brazil, Bulgaria, Jordan, Samoa, Thailand, and Tunisia — also performed substantially below the median in at least one area, although Jordan was selected to participate in the Threshold program. What separated these latter six from El Salvador and Namibia, however, was not explained by the Board.

Although the Gambia was selected in FY2006, its eligibility for MCA assistance was suspended by the MCC Board on June 16, 2006, because of “a disturbing pattern of deteriorating conditions” in half of the 16 conditions that are used to determine

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<sup>9</sup> Georgia and Senegal were selected despite not passing the necessary hurdles, but both had been chosen in FY2004 and FY2005.

<sup>10</sup> See, for example, Steve Radelet, Kaysie Brown, and Bilal Siddiqi, “Round Three of the MCA: Which Countries are Most Likely to Qualify in FY 2006?” Center for Global Development, October 27, 2005.

<sup>11</sup> Cape Verde had been classified as an eligible low-income country in FY2004 and signed a Compact in July 2005. The Cape Verde case, however, also points out a limitation in using the system of 16 performance indicators. For two of the economic categories, no data are available for Cape Verde, resulting in a failing score on those hurdles.

candidate countries. Among the problems cited in this case were human rights abuses, restrictions on civil liberties and press freedom, and worsened anti-corruption efforts.

On November 8, 2006, the MCC Board added three new countries to the list of those eligible for MCA grants — Moldova, Jordan, and Ukraine. Even prior to the selection, the possible choice of Jordan had come in for severe criticism. Freedom House, the organization whose annual Index of Freedom is drawn upon for two of the “Ruling Justly” indicators, had urged the MCC Board to bypass countries that had low scores on political rights and civil liberties. It argued that countries like Jordan that fall below 4 out of a possible 7 on its index should be automatically disqualified. Jordan, however, did well on three of the six other indicators in this category. Several development analysts further argued that Jordan should not be selected, because the MCA is not an appropriate funding source. They assert that Jordan already is one of the largest recipients of U.S. aid, has access to private sector capital, and is not a democracy.<sup>12</sup> In selecting Jordan, the MCC Board appears not to have been swayed by these arguments.

Another concern expressed by observers regarding the FY2007 selection process was that four of eleven current Compact countries — Ghana, Benin, Madagascar, and Cape Verde — would fail if measured under FY2007 indicators. While it was not expected that existing Compact funding would be withdrawn as it is based on eligibility in previous years, some had hoped the Board would send a signal of disapproval of such lapses. However, the MCC Board did not address this issue at the November 2006 candidate selection meeting.

**Country Selection — FY2008.** On March 11, 2008, the MCC Board added the Philippines to the list of countries eligible to apply for a Compact. It joins 24 countries, previously selected on December 12, 2007. Of these, Malawi is the only other new entry. Two countries that had appeared in the past were absent in the 2008 list. Sri Lanka is left out because of the resurgent civil strife that would make a Compact problematic, and Cape Verde for more complicated reasons. Under the recent changes in the qualifying indicators, Cape Verde would not have been eligible for the third year in a row, and, as a lower-middle income country, is more strictly judged. Nonetheless, according to the MCC, 12 of the 24 countries that made the cut this year did not meet the FY2008 criteria, five of them failing the control of corruption indicator. One reason that the MCC has re-selected these countries is that they are viewed as maintaining or improving their performance rather than adopting policies contrary to the criteria. This approach is taken because countries following reasonable policies may fall behind the performance criteria when other countries are improving faster — thereby raising the bar — when new criteria are introduced which countries have not had an opportunity to address and when institutions measuring performance refine or revise their indicators.

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<sup>12</sup> Freedom House, “Millennium Challenge Corporation Should Hold Countries to Higher Standards of Democratic Governance,” November 2, 2006 [<http://www.freedomhouse.org>]; Sheila Herrling, Steve Radelet, and Sarah Rose, “Will Politics Encroach in the MCA FY2007 Selection Round? The Cases of Jordan and Indonesia,” Center for Global Development, October 30, 2006, [<http://www.cgdev.org>].

### Low-Income Countries

Benin	Malawi*
Bolivia	Mali
Burkina Faso	Moldova
East Timor	Mongolia
Georgia	Mozambique
Ghana	Nicaragua
Honduras	Philippines*
Lesotho	Senegal
Madagascar	Tanzania
	Vanuatu

### Lower-Middle-Income Countries

Armenia	Morocco
El Salvador	Namibia
Jordan	Ukraine

\* New for FY2008.

## MCA Compacts and Program Proposals

Once declared as eligible, countries may prepare and negotiate program proposals with the MCC. Only those Compact proposals that demonstrate a strong relationship between the program proposal and economic growth and poverty reduction will receive funding. Not all qualified MCA countries may submit successful Compact proposals.

While acknowledging that Compact proposal contents likely will vary, the Corporation expects each to discuss certain matters:

- a country's strategy for economic growth and poverty reduction, impediments to the strategy, how MCA aid will overcome the impediments, and the goals expected to be achieved during implementation of the Compact;
- why the proposed program is a high priority for economic development and poverty reduction and why it will succeed; the process through which a public/private dialogue took place in developing the proposal;
- how the program will be managed, monitored, and sustained after the Compact expires;
- the relationship of other donor activities in the priority area;
- examples of projects, where appropriate;
- a multi-year financial plan; and
- a country's commitment to future progress on MCA performance indicators.

The Corporation did not set hard deadlines for Compact submissions in order to allow countries adequate time to conduct a national dialogue over the contents of

the program proposal. Proposals are developed by a country with the guidance and in consultation with the MCC. Sometime during the proposal development process, the MCC may provide so-called pre-Compact development grants to assist the country's efforts. Among other things, grants may be used for design studies, baseline surveys, technical and feasibility studies, environmental and social assessments, ongoing consultations, fees for fiscal and/or procurement agents, and the like. In December 2007, the MCC provided Burkina Faso with a pre-Compact development grant of \$9.4 million, not counted as part of the final Compact.

Once a proposal is submitted, the MCC conducts an initial assessment, then, on the basis of that assessment, launches a due diligence review that closely examines all aspects of the proposal, including costs and impacts. At the same time, MCC staff work with the country to refine program elements. Finally, the MCC negotiates a final Compact agreement prior to its approval by the MCC Board. The Compact is signed but does not enter into force until supplemental agreements on disbursements and procurement are reached.<sup>13</sup>

The MCC signed its first Compact, with Madagascar, on April 18, 2005, an event that was followed by four other signings in 2005 — with Honduras, Cape Verde, Nicaragua, and Georgia. In 2006, six more agreements were signed: Benin, Vanuatu, Armenia, Ghana, Mali and El Salvador. In 2007, four Compacts were signed — with Mozambique, Lesotho, Morocco, Mongolia. In 2008, only one, with Tanzania, has been signed to date.

The case of Madagascar is a good example of how the Compact process is expected to take shape. Elements of the design, negotiation, and completion of the Madagascar Compact met several of the key criteria of the MCA process. Discussions regarding the scope and purpose of the MCA grant occurred at the regional and national level in Madagascar that included broad representation of civil society. Management and oversight of the Compact will be handled by a new entity, MCA-Madagascar, whose Steering Committee will include government and non-government officials. Both of these steps underscore the “country-ownership” and broad participatory nature of MCA programs. The Compact also includes fiscal accountability requirements concerning audits, monitoring, and evaluation that support the transparency concept of the MCA. While the \$110 million MCA grant was fully obligated when the Compact entered into force, resources will be transferred periodically following a determination that performance continues satisfactorily. This funding plan emphasizes the MCA principles of accountability and results.

**Compact Descriptions.** The 16 Compacts agreed up to this point are described below (also see **Table 2**). In addition to individual Compact components noted in each description, Compact totals include administrative and monitoring costs.

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<sup>13</sup> Details on each of the negotiated Compacts can be found at the MCA website: [<http://www.mcc.gov>].

**Madagascar.** The Madagascar Compact is a four-year, \$110 million program, focusing on rural agriculture development and poverty reduction. Specifically, the project has three objectives: 1) to increase land titling and land security (\$36 million); 2) to expand the financial sector and increase competition (\$36 million); and 3) to improve agricultural production technologies and market capacity in rural areas (\$17 million). According to the MCC, the Compact is designed to assist Madagascar's rural poor, which account for 80% of the nation's impoverished population, and generate income by expanding opportunities to own land, to access credit, and to gain technical training in agriculture and market identification.

**Honduras.** The five-year, \$215 million MCA Compact with Honduras focuses on two objectives — rural development and transportation. The rural development project, representing \$72.2 million of the Compact, will assist small and medium-size farmers enhance their business skills and to transition from the production of basic grains to horticultural crops, such as cucumbers, peppers, and tomatoes. According to the MCC, these vegetable crops will generate about \$2,000 to \$4,000 in annual income per hectare, compared with roughly \$500 for basic grains. The project intends to provide farmers with the appropriate infrastructure and necessary training for producing and marketing these different crops. The transportation project, totaling \$125.7 million of the Compact, will improve the major highway linking Honduran Atlantic and Pacific ports, and major production centers in Honduras, El Salvador, and Nicaragua. Rural roads will also be upgraded, helping farmers transport their goods to markets at a lower cost. Specific results sought in the Compact are:

- double productivity in 15,000 hectares in rural areas
- expand access to credit for farmers by over 20%
- upgrade the major road that links Honduras with commercial centers
- upgrade about 1,500 kilometers of rural roads

**Cape Verde.** The MCC and Cape Verde have signed a five-year, \$110 million Compact focused largely on improving the country's investment climate, transportation networks, and agriculture productivity. The program's goal is to increase the annual income in Cape Verde by at least \$10 million. The Compact evolves around three projects:

- Private Sector Development — with \$7.2 million and additional participation with the International Finance Corporation, the project aims to remove constraints to private sector investment.
- Infrastructure — the project will invest \$78.7 million in road and bridge construction to help link the nine inhabited islands and improve transportation links to social services, employment opportunities, local markets, and ports and airports.
- Watershed Management and Agriculture Support — by investing \$10.8 million to increase the collection, storage, and distribution of rainfall water, the project hopes to increase agricultural production and double the household income of farmers.

**Nicaragua.** The five-year, \$175 million Compact with Nicaragua will focus on the promoting economic growth primarily in the northwestern region of the



country where potential opportunities exist due to the area's fertile land and nearby markets in Honduras and El Salvador. The Compact has three components: 1) to strengthen property registration (\$26.5 million); 2) to upgrade primary and secondary roads between Managua and Leon and to provide technical assistance to the Ministry of Transportation (\$92.8 million); and 3) to promote higher-profit agriculture activities, especially for poor farmers, and to improve water supply in support of higher-value sustainable agriculture.

**Georgia.** The \$295 million, five-year agreement with Georgia focuses on reducing poverty and promoting economic growth in areas outside of the capital where over half the population lives in poverty. The Compact is divided into two projects. The first and the largest component (\$211.7 million) concentrates on infrastructure rehabilitation, including roads, the north-south gas pipeline, water supply networks, and solid waste facilities. The Enterprise Development Project (\$47.5 million) will finance an investment fund aimed at providing risk capital and technical assistance to small and medium-sized businesses, and support farmers and agribusinesses that produce commodities for the domestic market. The program expects to:

- reduce in the incidence of poverty by 12% in the Samtskhi-Javakheti region;
- provide direct benefits to 500,000 people and indirectly benefit over 25% of Georgia's population;
- reduce the travel time by 43% to Tbilisi, the capital, from regional areas, thereby cutting transportation costs for farmers, businesses, and individuals needing health and other social services; and
- lower the risk of a major gas pipeline accident and improve the reliability of heat and electricity to over one million Georgians.

**Armenia.** The five-year, \$236 million Compact concentrates on the agricultural sector, investing in the rehabilitation of rural roads (\$67 million) and improving irrigation (\$146 million). The program anticipates that it will benefit about 750,000 people, 75% of Armenia's rural population, by improving 943 kilometers of rural roads and increasing the amount of land under irrigation by 40%.

Misgivings have been raised both prior to and during implementation of the Armenia Compact. In September 2005, the MCC expressed concerns with Armenian officials regarding slippage on two of the governance indicators and matters raised by international groups concerning political rights and freedoms in the country. Moreover, the MCC Board delayed final approval of the Compact following the November 27, 2005, constitutional referendum, after allegations of fraud, mismanagement, limited access by the press, and abuse of individuals were raised. In signing the Compact on March 27, 2006, the MCC issued a cautionary note, signaling that Armenia must maintain its commitment to the performance indicators or risk suspension or termination of the Compact. On March 11, 2008, the MCC issued a warning that assistance might be suspended or terminated in response to the

government's actions, including the imposition of a state of emergency and restrictions on press freedoms.<sup>14</sup>

**Vanuatu.** The \$65.7 million, five-year Compact targets improvements broadly in multiple types of infrastructure, including roads, wharfs, an airstrip, and warehouses. The objective is to increase the average per capita income by 15%, by helping rural agricultural producers and providers of tourism-related goods and services. The Compact further aims to help strengthen Vanuatu's Public Works Department in order to enhance capacity to maintain the country's entire transport network.

**Ghana.** The five-year \$547 million Compact focuses on agriculture and rural development. Poverty rates in the three targeted geographic areas are above 40%. The agriculture component (\$241 million) will provide training for farmer-based organizations, improve irrigation, provide greater access to credit, and rehabilitate local roads. The transport component (\$143 million) will seek to reduce transport costs to farmers by improving key roads, such as the one between the capital and the airport, and an important ferry service. Rural development programs (\$101 million) will construct and rehabilitate education, water, and electric facilities, among other activities.

**Benin.** Benin, one of the world's poorest countries with the lowest Human Development Index ranking of any MCC Compact nation, has been approved for a \$307 million, five year program focused on four sectors:

- Land rights, reducing the time and cost of obtaining property title;
- Financial services, helping micro, small, and medium-sized businesses;
- Justice reform, assisting the judicial systems capacity to resolve business and investment claims; and
- Market access, improving the Port of Cotonou.

The Compact's goal is to benefit five million people, bringing 250,000 of the population out of poverty by 2015.

**Mali.** The five-year \$461 million Compact emphasizes an increase in agricultural production and expansion of trade. About half the funds (\$234.6 million) will support a major irrigation project, including modernization of infrastructure and improvements in land tenure. Improvements in the airport (\$89.6 million) will target both passenger and freight operations. An industrial park project located at the airport (\$94.6 million) will assist agro-processing and other industry.

**El Salvador.** The five-year \$461 million Compact will address economic growth and poverty reduction concerns in El Salvador's northern region where more than half the population lives below the poverty line. Education as well as water and sanitation, and electricity supply (\$95.1 million); support for poor farmers and small

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<sup>14</sup> See letters of John Danilovich to Armenia President Robert Kocharyan on December 16, 2005 and March 11, 2008 on MCC website.

and medium-sized business (\$87.5 million); and transportation, including roads (\$233.6 million) are the chief elements of program.

**Mozambique.** The five-year \$506.9 million Compact, like most other Compacts, targets specific districts, in this case the less prosperous North of the country. The Compact has four components. Water and sanitation services will be improved (\$203.6 million), a major road will be rehabilitated (\$176.3 million), land tenure services will be made more efficient (\$39.1 million), and steps will be taken to protect existing coconut trees, improve coconut productivity, and support diversification to other cash crops (\$17.4 million). The long-term objective is to reduce the projected poverty rate by more than 7%.

**Lesotho.** The five-year \$362.6 million Compact has three elements. A water sector project (\$164 million) will focus on both industrial, supporting garment and textile operations, and domestic needs. It will also support a national watershed management and wetlands conservation plan. A health project (\$122.4 million) will seek to strengthen the health care infrastructure, including renovation of up to 150 health centers, improved management of up to 14 hospital out-patient departments, construction and equipping of a central laboratory, and improved housing for medical staff and training for nurses. A private sector development project (\$36.1 million) will address a wide range of legal and administrative obstacles to increased private sector activity, including development of land policy and administration authority, implementation of a new payments and settlement system, and improvement of case management of commercial courts.

**Morocco.** The five-year, \$697.5 million Compact has multiple components, all aimed at increasing private sector growth. These include efforts to increase fruit tree productivity (\$300.9 million), modernize the small-scale fisheries industry (\$116.2 million), and support artisan crafts (\$111.9 million). In addition, the Compact will fund financial services to micro-enterprises (\$46.2 million) and will provide business training and technical assistance aimed at young, unemployed graduates (\$33.9 million).

**Mongolia.** The most significant part of the five-year \$285 million Compact intends to stimulate economic growth by refurbishing the rail system, including infrastructure and management (\$188.38 million). In addition, the Compact will support improvements in the property registration and titling system (\$23.06 million) and the vocational education system (\$25.51 million). The Compact will also attempt to reform the health system to better address non-communicable diseases and injuries, which are rapidly increasing in the country (\$17.03 million).

**Tanzania.** The five-year, \$698 million Compact will focus on three key economic infrastructure issues. A transport sector project (\$373 million) will improve major trunk roads, select rural roads, general road maintenance capabilities, and upgrade an airport. An energy sector project (\$206 million) will lay an electric transmission cable from the mainland to Zanzibar, will construct a small hydro-electric plant at Igamba Falls, and will rehabilitate the existing distribution system to unserved areas. A water sector project (\$66 million) will expand a clean water treatment facility serving the capital, reduce water loss in the capital region, and improve the water supply in Morogoro, a growing city.

## “Threshold” Countries and Programs

In order to encourage non-qualifying countries to improve in weak areas, the MCC will help governments that are committed to reform to strengthen performance so that they would be more competitive for MCA funding in future years. Congress provided in authorizing legislation that not more than 10% of MCA appropriations could be used for such purposes, stating that the funding could be made available through USAID. Subsequent foreign operations appropriations have made 10% of new MCA appropriations available for this Threshold assistance.<sup>15</sup>

According to the Threshold Program Policy guidance issued by the Corporation,<sup>16</sup> the program will assist countries make policy reforms and institutional changes in areas where they failed to meet the MCA performance criteria. Those countries deemed eligible for the program must submit concept papers identifying:

- where and why the country failed to pass specific indicators;
- proposals for policy, regulatory, or institutional reforms that would improve the country’s performance on these indicators; and
- types of assistance, over a two-year maximum period, required to implement these reforms.

If the Corporation, in consultation with USAID, determines that the concept paper shows sufficient commitment to reform and a promise of success, the country will prepare a Threshold Country Plan that specifically establishes a program schedule, the means to measure progress, and financing requirements, among other considerations. USAID is charged with overseeing the implementation of Threshold Country Plans, including working with countries to identify appropriate implementing partners such as local, U.S., and international firms; NGOs; U.S. government agencies; and international organizations. Like regular MCA Compacts, funding is not guaranteed for each country selected for the Threshold Program, but will be based on the quality of the Country Plan.

Currently, 22 countries are eligible for threshold assistance. To date, the threshold programs of 19 countries totaling \$420 million have been approved by the MCC Board — Albania, Tanzania, Burkina Faso, Malawi, Moldova, Philippines, Zambia, Jordan, Indonesia, Ukraine, Paraguay, Kenya, Uganda, Guyana, Kyrgyz Republic, Yemen (program postponed on October 26, 2007, pending review), Sao Tome and Principe, Peru, and Niger. Countries that are eligible but have not yet been awarded threshold program support are East Timor, Rwanda, and Mauritania. The latter country was added on December 12, 2007. At the same time, the MCC Board invited three countries — Albania, Paraguay, and Zambia — to submit proposals for follow-on threshold programs (stage II) as their initial threshold programs will expire this year.

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<sup>15</sup> Initially, assistance for Threshold countries was authorized only for FY2004.

<sup>16</sup> Found at [<http://www.MCC.gov>].

Funding levels for threshold programs differ, most recently ranging from \$8.7 million for Sao Tome and Principe to \$35.6 million for Peru. Of the 19 programs, 15 seek to improve country scores on the corruption indicator. Several countries have multiple objectives. Indonesia and Peru, for example, target both corruption and immunization indicators. Albania focuses on corruption and improvements in its business environment. The Burkina Faso program is designed to improve girls' primary education, targeting areas of the country with the lowest primary completion rates.

## **Select Issues**

### **Role of USAID and the Future of Agency Programs in MCA Countries**

How USAID would participate in the MCA initiative has been a continuing concern of Congress and various policy analysts. Legislation authorizing the MCC requires the Corporation's CEO to coordinate and consult with USAID and directs the Agency to ensure that its programs play a primary role in helping candidate countries prepare for MCA consideration. USAID maintains missions in most of the eligible countries and might be expected to support MCC programs, through contracting, procurement, and monitoring tasks. Although USAID is the chief implementor on behalf of the MCC of threshold programs, its role in other aspects of MCC activities is not clear.

Another question is how USAID will adjust its own programs in MCA countries. Then-USAID Administrator Natsios told the House Appropriations Committee on May 13, 2004, that the Agency would not withdraw from or cut programs in MCA countries, but would not increase spending either. He said, however, that USAID would work to ensure that its programs operate in an integrated way with MCA-funded activities. Nonetheless, some critics continue to express concern that MCA funding is not always additive, as had been the pledge, but will substitute for portions of previous USAID bilateral development aid programs. The FY2008 budget request offers a look at how funding levels may be affected by MCA Compacts. With the exceptions of new entries Lesotho, Mozambique, and Morocco, in Compact countries where there has been a bilateral economic assistance program, that assistance would be reduced under the FY2008 budget plan from FY2006 levels. In its FY2008 report on the State/Foreign Operations bill (H.Rept. 110-197), the House Appropriations Committee made note of this trend and expressed the view that MCC aid should be "a complement," not a substitute, to the current aid program.

### **Compact Sectors**

One feature of the first series of Compacts drew particular attention. Most of the early Compacts included a similar sector concentration, focusing on agriculture and transportation infrastructure projects. While these activities are well justified, the similarity across Compacts surprised some observers. Given the wide diversity of conditions in each of the countries, plus the Corporation's willingness to support all types of programs, many had expected to see a greater degree of variation among

the Compacts. Some believe that social sectors, including those in health and education, should be receiving greater attention in Compact design. Others had expected greater variety in aid delivery mechanisms, and are concerned that the MCC is reluctant to approve sector grants and other types of budget support assistance. While there can be greater accountability risks associated with this kind of aid, countries that qualify for MCA support are selected because they have already demonstrated stronger performance in managing resources and fighting corruption.<sup>17</sup> As more Compacts are signed, some diversity in programs is creeping in — three of the more recent ones, in Lesotho, Mozambique, and Tanzania, feature a water and sanitation component. The Morocco Compact includes micro-credit and artisan crafts support among its projects.

## Compact Size

A second closely examined characteristic of the early Compacts was the dollar size of the grants; or, more specifically, the lower-than-anticipated funding level for the first several Compacts. While Administration officials said repeatedly that Compacts would be funded at various levels depending on the nature and potential impact of the proposal, the presumption was that the MCA grant would represent a sizable increase in U.S. assistance to the eligible country. In order to realize its potential as a “transformational” aid program and to provide sufficient incentives to countries requesting “breakthrough” projects, the MCC says that the size of its grants must place MCA assistance among the top aid donors in a country.<sup>18</sup> Some had estimated that once the Corporation’s budget reached \$5 billion, each Compact would be supported with annual resources in the \$150-\$200 million range.<sup>19</sup> These levels could vary up or down depending on many factors, such as the number of people living in poverty, the size of the economy, and the scope of the proposed projects.

Most of the first several Compacts, however, did not meet the anticipated financial allocation thresholds. Madagascar’s four-year, \$110 million Compact roughly doubled U.S. assistance to the country, but did not place MCA assistance among the top donors. France was the largest bilateral donor, disbursing on average \$189 million per year, 2001-2004. The European Commission’s aid program, 2001-2004, averaged \$82 million per year, while the World Bank’s International Development Association was Madagascar’s largest source of concessional assistance of about \$209 million lent in each of 2001 through 2004.<sup>20</sup> The \$110 million Compact for Madagascar is also not very large relative to the country’s

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<sup>17</sup> James Fox and Lex Rieffel, *The Millennium Challenge Account: Moving Toward Smarter Aid*. The Brookings Institution, July 14, 2005, p. 24.

<sup>18</sup> See, for example, Millennium Challenge Corporation FY2005 Budget Justification, p. 7. Found at [[http://www.mcc.gov/about/reports/congressional/budgetjustifications/budget\\_justification\\_fy05.pdf](http://www.mcc.gov/about/reports/congressional/budgetjustifications/budget_justification_fy05.pdf)].

<sup>19</sup> Prepared statement of Steve Radelet, Senior Fellow at the Center for Global Development, before a hearing of the House International Relations Committee, April 27, 2005.

<sup>20</sup> Organization for Economic Cooperation and Development (OECD), *Geographical Distribution of Financial Flows to Aid Recipients, 2000/2004: 2006 edition*.

population. Of the 16 qualified countries for FY2004, Madagascar had the fourth largest population (16.4 million), and might have been expected to receive one of the larger MCA grants given its population size and its per capita income (\$230, second lowest among the 16 MCA countries).

For Honduras (a \$215 million MCA program over five years), Georgia (\$295 million over five years), and Armenia (\$236 million over five years), the United States has been the top bilateral donor in recent years without the MCA program, and will likely remain in that position as MCA are disbursed. But the MCA Compact for Honduras called for only a slightly higher annual amount (\$43 million) than U.S. economic assistance provided (\$34 million) at the time, while Georgia's Compact will average only about three-fourths and the Armenia Compact only about two-thirds of the annual level of recent American aid. While these are not insignificant amounts of new resources, they are far less than Administration officials had suggested previously.<sup>21</sup>

In contrast, the five-year Compacts with Cape Verde (\$110 million), Benin (\$307 million), Vanuatu (\$66 million), Ghana (\$547 million), Mali (\$461 million), and El Salvador (\$461 million) represent a substantial investment by the United States, relative to the size of recent American aid and the size of their economies. USAID, which last provided direct bilateral assistance to Cape Verde in the mid-1990s, does not maintain a mission presence, allocating small amounts of aid through regional programs. The Compact's \$22 million annual average places the United States second to Portugal, Cape Verde's former colonial power, as the leading donor, and represents more than a quarter of total bilateral development aid grants from all sources compared with figures for 2003 and 2004. Likewise, the United States does not maintain a bilateral program with Vanuatu, limiting direct aid through the Peace Corps. The \$13 million annual average of the Vanuatu program places the United States as the country's top aid donor, along with Australia. In Benin, USAID manages an annual bilateral economic aid program of about \$15 million, compared with the \$61 million annual size of the MCC Compact. The Compact likely places the MCC as the top aid donor, together with France, for Benin.<sup>22</sup>

This issue has been a priority of Ambassador Danilovich since his September 27, 2005 confirmation hearing to be the MCC's new CEO. He noted that the MCC was "meant to create transformative programs," and to do so he said that "future Compacts will generally need to be larger than those signed thus far." Ambassador Danilovich cautioned, however, that with limited resources but larger Compacts, fewer countries will receive funding if MCC is to achieve its transformational goal.<sup>23</sup> His record since assuming the CEO position appears to be moving towards larger Compacts and placing the MCC as the largest donor in recipient countries.

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<sup>21</sup> For example, USAID Administrator Natsios remarked in an October 22, 2002 speech at the American Embassy in London that "we estimate in most countries the MCA will provide funding 5 to 10 times higher than existing levels" of U.S. assistance.

<sup>22</sup> *Geographical Distribution of Financial Flows to Aid Recipients, 2000/2004: 2006 edition.*

<sup>23</sup> Prepared statement of John J. Danilovich, before the Senate Committee on Foreign Relations, September 27, 2005.

## Speed of Implementation

A recurrent criticism of the MCC, especially in Congress, is the slow speed of implementation, reflected largely by the limited amount of disbursements made to date. As perhaps the leading cause of cuts in MCC funding from the Administration request and of threatened rescissions from amounts already appropriated, this view has had severe consequences for the MCC (see below). As of the end of March 2008, of the \$7.5 billion appropriated for the MCC, only \$629 million, or 8%, has been disbursed.

There are some good reasons for this spending rate. The MCC is a new experiment, and it has taken considerable time to develop methods of operation, including settling on the rules of eligibility and the requirements of Compact proposals. Further, the countries themselves are responsible for developing proposals, and they have problems common to most developing countries in managing complex programs to meet donor requirements of accountability. The GAO found that for five signed Compacts in Africa — with Madagascar, Cape Verde, Benin, Ghana, and Mali — the process of going from eligibility to compact signature took between 12 and 31 months. Four of these compacts entered into force about five months after compact signature.<sup>24</sup>

Once launched, Compacts may be slow to get underway. For two in their third year — Madagascar and Cape Verde — disbursements have been slow, only 27% and 16%, respectively, of planned disbursements had been made by end of March 2008. Among the causes are delays by these Compact countries in filling managerial positions. The nature of many of the Compacts is also responsible for the delays. Typically, infrastructure projects are slow to disburse funds, the majority of activity in the first few years being the design and planning of projects rather than actual construction.

Whatever the causes, the MCC has responded to the criticisms by arguing that projected annual Compact disbursements by 2009 will top \$1 billion. The MCC is also attempting to shift its organizational focus from the early emphasis on Compact development to Compact implementation. In October 2007, it announced a reorganization aimed at facilitating implementation.

## Compact Impact

The purpose of the MCA is to reduce poverty by supporting economic growth, but some observers have complained about the lack of measurable results to date. There are some possible reasons for this, most prominently the slow speed of Compact implementation noted above. As a result, it will likely be some time before a serious analysis of actual impacts can be undertaken.

A recent GAO report highlighted a related concern, that, in the case of Vanuatu, projected impacts have been overstated. Among many the economic factors

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<sup>24</sup> Government Accountability Office, *Millennium Challenge Corporation: Progress and Challenges with Compact in Africa*, Testimony, June 28, 2007, GAO-07-1049T.



considered in its report, the GAO notes that the MCC estimated a rise from 2005 per capita income in Vanuatu of about 15% (\$200) by 2015 when, in fact, the data suggest it would rise by 4.6%. Although the MCC states that the Compact would benefit 65,000 poor, rural inhabitants, the data, according to the GAO, do not establish the extent of benefit to the rural poor. Further, the MCC projections assume continued maintenance of projects following completion, whereas the experience of previous donors is that such maintenance has been poor.<sup>25</sup> The MCC response is that, although there may be varying views on the degree of benefit, both agencies agree that the underlying data show that the Compact will help Vanuatu address poverty reduction.<sup>26</sup>

In lieu of results from the Compacts, MCC officials have pointed to the impact made by the MCC process itself. Under the so-called MCC effect, many countries are said to be establishing reforms in an effort to qualify under the 17 indicators. Yemen has been cited in this regard, because, following its suspension from the threshold program in 2005, it approved a number of reforms to address indicators where its performance had lapsed (and subsequently was reinstated). Both the House and Senate approved resolutions in 2007 (H.Res. 294 and S.Res.103) noting the role the MCC played in encouraging Lesotho to adopt legislation improving the rights of married women.

## Rising Costs

The majority of Compact projects support construction of economic infrastructure, primarily roads and water and sanitation systems. In the past year, costs for the machines and material necessary for these activities have been rising worldwide. At the same time, the U.S. dollar has depreciated significantly. As a result, MCC projects are faced with having less funding than envisioned to meet the agreed-on objectives. The MCC reports that at least six projects are expected to be scaled-back from the original plans or may be supplemented by financing from other sources.

## Funding Issues

In each year since the MCA was established, the MCC proposal was by far the largest increase sought by the Administration in the Foreign Operations appropriations bill and viewed by many observers as one of the most vulnerable items in an increasingly difficult budget environment. In each year as well, its enacted appropriation has been well below the President's request.

Supporters of the MCC are disturbed by this trend, reflected again in the congressional funding level for FY2008, well below the Administration request. They argue that countries that have gone through the whole process of seeking

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<sup>25</sup> Government Accountability Office, *Millennium Challenge Corporation: Vanuatu Compact Overstates Projected Program Impact*, July 2007, GAO-07-909.

<sup>26</sup> Testimony of Rodney Bent before the House Committee on Foreign Affairs, Subcommittee on Asia, the Pacific, and the Global Environment, July 26, 2007.

eligibility and designing and refining a proposal are likely to seek funding elsewhere if they have to wait long for MCC funding to become available. Further, the so-called MCC effect, which encourages countries to reform on their own in order to meet eligibility requirements, is likely to be lost if fewer Compacts are offered annually.

**Table 1. MCA Appropriations: FY2004-2008**  
(in \$ billions)

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
Request	1.300	2.500	3.000	3.000	3.000	2.225
Appropriation	0.994	1.488	1.752	1.752	1.544	—

**MCA Request and Congressional Action for FY2008.** On February 5, 2007, the Administration requested a FY2008 appropriation of \$3 billion for the MCA. In its budget presentation, the MCC argued that available resources were expected to be fully utilized on Compacts likely to be signed in 2007, including Lesotho, Morocco, Mozambique, Tanzania, and Sri Lanka. Expected to be left in the pipeline for funding in FY2008 were 9 to 10 countries, possibly including Jordan, Moldova, and Ukraine. If fully funded at \$3 billion, the MCC could support about six of these compacts in FY2008.

On June 22, 2007, the House approved H.R. 2764, the FY2008 State/Foreign Operations appropriations, providing \$1.8 billion to the MCC, \$1.2 billion or 40% below the Administration request and roughly the same as in FY2007. The Appropriations Committee expressed support for the MCC and pointed to budget constraints as the cause of the reduction (H.Rept. 110-197). On September 6, 2007, the Senate approved its version of the FY2008 appropriations, providing \$1.2 billion for the MCC, \$1.8 billion (or 60%) below the Administration request and a 32% decline from the FY2007 level. The bill, however, also contained a provision that would allow the Administration to transfer up to \$200 million in State Department Diplomatic and Consular Program account funds to the MCC. As the funding level provided for this account is less than the request, a transfer appeared to some unlikely.

An amendment added on the Senate floor would require the MCC to obligate no more than half of the promised Compact total. Currently, under annual appropriations language, the full amount of a Compact must be committed at the time of signing (in practice, it is obligated when the Compact enters into force). The impact of this change would be to allow the MCC to sign more Compacts with fewer up-front appropriations. It might also lessen the impression that the MCC has inordinately large amounts of undisbursed obligations available for possible congressional diversion to other aid programs. On the other hand, it may suggest to countries that full payment of Compacts is not guaranteed, leaving them wondering if it is worth their time and effort to seek one.

By way of an explanation for the deep cut in the MCC request, the Senate Appropriations Committee report on the bill (S.Rept. 110-128) contained a number

of serious criticisms of the MCC that amounted to a challenge to its mode of operation. The committee pointed out that the MCC had only disbursed one-thirtieth of its obligations under the first 11 Compacts, raising the possibility of there being undisbursed amounts at the end of the Compact term. The committee noted that few tangible results could be measured from these Compacts. It questioned the usefulness of a possible Compact with Tanzania for its large size (nearly \$700 million) relative to a small population and weighed against the similar size of the total FY2008 Development Assistance and ESF request for all of sub-Saharan Africa. Further, the committee raised the concern that some Compacts have been made with countries of relatively little strategic importance to the United States. Finally, it criticized the lack of Compacts with health, education, or governance components.

These concerns appear to strike at the heart of the MCC model. Supporters of the MCC would argue that large amounts of undisbursed obligations at the early stages of a Compact are intrinsic to the guarantee that funds will be available as contracted and not be subject to the uncertainty of future appropriations. They might also argue that immediate results from uncompleted development projects are rare, and that the early plan for the MCC was that Compacts would be larger than other U.S. and most competing donor aid programs and sufficiently large to have a real impact in a country, that their purpose would be developmental and not strategic, and that their nature would be determined by the Compact country requesting such aid and not reflect U.S. sectoral preferences. However, even many defenders of the MCC appear to share the concern regarding the slow speed of project implementation and the choice of sectors, despite the fact that both features may be the result of putting power into the hands of the aid recipients as much as any fault of the MCC itself.

On December 26, 2007, the FY2008 Consolidated Appropriations Act (P.L. 110-161, H.R. 2764) was signed into law. It provides \$1.544 billion (after a .81% rescission) for the MCA, \$1.5 billion less than the Administration request.

On May 22, 2008, the Senate approved its version of H.R. 2642, the FY2008 and FY2009 war supplemental. The bill includes two committee amendments that would rescind \$525 million in FY2008 funding from the MCA, cutting its FY2008 total budget by one-third to a level of \$1 billion. The funds would be used to provide disaster aid to Burma (\$225 million) and economic and military aid to Jordan (\$300 million). In effect, one planned Compact — likely that of Burkina Faso or Namibia — would have to be postponed if the Senate provisions are adopted in conference with the House.

**MCA Request and Congressional Action for FY2009.** On February 4, 2008, the Administration requested \$2.225 billion for the MCA in its FY2009 budget, a 44% increase over the FY2008 appropriation.

## **Authorizing Legislation and MCC Reform**

Many observers anticipate that an MCC reauthorization measure will be considered in the 111<sup>th</sup> Congress. A previous effort, in the 109<sup>th</sup> Congress (2006), was reported by the House International Relations Committee (H.R. 4014, H.Rept. 109-563), but received no further consideration. It would have authorized MCC

appropriations (“such sums as may be necessary”) for fiscal years 2007 through 2009. The requirement of an authorization of foreign aid programs has been routinely waived in annual Foreign Operations appropriations bills, as the FY2008 Consolidated measure did in the case of currently unauthorized foreign aid programs, including the MCA.

In addition to funding provisions, H.R. 4014 made a number of policy modifications to the original legislation and to the operations of the Corporation, many of which continue to be discussed for some future authorization effort. These included allowing Compacts to last up to 10 years, instead of the five currently permitted; allowing two concurrent Compacts, rather than the current one; and requiring notification to authorizing and appropriating Committees 15 days prior to signing a Compact (as in the procedures of reprogramming notifications under section 634A of the Foreign Assistance Act), in place of existing language requiring that the MCC consult with “appropriate committees” prior to negotiating a Compact. Reflecting concerns regarding the slow speed of implementation, the bill expressed the sense of Congress that the MCC should encourage countries to submit Compact proposals within one year of being declared eligible, enter into a Compact within two years, and to consider removing countries from the status of eligibility if they do not comply with these guidelines in a timely and good faith manner.

**Table 2. Status of MCA Compacts**

Country	Compact Signed	GNI per capita	Population Living Below \$2 p/day (%)	Human Development Index Ranking <sup>a</sup>	FY06 US Econ. Aid (millions) <sup>b</sup>	Compact Size (millions)	Compact Focus
Armenia	Mar. 27, 2006	\$1,930	31.1%	83	\$58.0	\$236 5 years	-Agriculture/irrigation -Rural roads
Benin	Feb. 22, 2006	\$540	73.7%	163	\$14.2	\$307 5 years	-Land and property -Financial services -Judicial improvement -Port rehabilitation
Cape Verde	July 4, 2005	\$2,130	NA	102	\$0.0	\$110 5 years	- Agriculture - Transport/roads - Private sector
El Salvador	November 29, 2006	\$2,540	40.5%	103	\$24.0	\$461 5 years	-Education -Transport/roads -Small business/farm development
Georgia	Sept. 12, 2005	\$1,560	25.3%	96	\$58.0 (\$0.7)	\$295 5 years	- Infrastructure/gas - Transport/roads - Agriculture/business
Ghana	August 1, 2006	\$520	78.5%	135	\$41.1 (\$0.3)	\$547 5 years	-Agriculture -Transport -Rural Development
Honduras	June 13, 2005	\$1,200	44.0%	115	\$27.7 (\$0.8)	\$215 5 years	-Agriculture -Transport/roads
Lesotho	July 23, 2007	\$1,030	56.1%	138	\$3.0 (\$6.4)	\$362.6 5 years	-Water sector -Health sector -Private sector
Madagascar	April 18, 2005	\$280	85.1%	143	\$26.0	\$110 4 years	- Land titling/Agriculture - Financial sector
Mali	November 13, 2006	\$440	90.6%	173	\$38.1	\$460.8 5 years	-Irrigation -Transport/airport -Industrial park

Country	Compact Signed	GNI per capita	Population Living Below \$2 p/day (%)	Human Development Index Ranking <sup>a</sup>	FY06 US Econ. Aid (millions) <sup>b</sup>	Compact Size (millions)	Compact Focus
Mongolia	October 22, 2007	\$880	74.9%	114	\$6.6	\$285 5 years	-Transport/rail -Property Rights -Voc Ed -Health
Morocco	August 31, 2007	\$1,900	14.3%	126	\$18.9	\$697.5 5 years	-Agriculture/Fisheries -Artisan Crafts -Financial Serv/ Enterprise Support
Mozambique	July 13, 2007	\$340	78.4%	172	\$44.9 (\$148.4)	\$506.9 5 years	-Water and Sanitation -Transportation -Land Tenure/Agriculture
Nicaragua	July 14, 2005	\$1,000	79.9%	110	\$24.1 (\$0.1)	\$175 5 years	- Land titling/Agriculture - Transport/roads
Tanzania	February 17, 2008	\$350	89.9%	159	\$57.3 (\$176.5)	\$698 5 years	-Transport/roads and airport -Energy -Water
Vanuatu	March 2, 2006	\$1,710	NA	120	\$0.0	\$66 5 years	-Transport rehab -Public Works Dept.

**Sources:** Population Living Below \$2 Per Day — data from the World Bank, *World Development Report, 2007*; Gross National Income per capita — 2006 data from the World Bank, *World Development Indicators*. Human Development Index Rank — from UNDP, *Human Development Report, 2006*. MCC Information: Millennium Challenge Corporation.

- a. The Human Development Index (HDI) is compiled by the U.N. Development Program and is published annually in the UNDP Human Development Report. It is a composite index that measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, as measured by life expectancy at birth; knowledge, as measured by the adult literacy rate and the combined gross enrolment ratio for primary, secondary, and tertiary schools; and a decent standard of living, as measured by GDP per capita in purchasing power parity (PPP) U.S. dollars. The most recent report (2007/08) evaluates 177 countries, with number 1 having the best HDI and number 177 scoring the worst in the Index.
- b. U.S. Economic Aid is defined here as Child Survival/Health, Development Assistance, Economic Support Fund, and FREEDOM Support Act. Figure in parenthesis is HIV/AIDS Initiative.

**Table 3A. MCA Low-Income Candidate, Eligible, Compact, and Threshold Countries — FY2008**

**Criteria:** Per capita income \$1,735 and below, and not prohibited from receiving other U.S. economic assistance.

**Compact Eligible Countries** are in Bold

**Compact Countries** are followed with (C)

**Threshold Eligible Countries** are in Italics

**Threshold Program Countries** are followed with (TC)

Africa	Income <sup>a</sup>	East Asia/Pacific	Income <sup>a</sup>	Latin America	Income <sup>a</sup>
<b>Benin (C)</b>	\$540	Cambodia	\$480	<b>Bolivia</b>	\$1,100
<b>Burkina Faso (TC)</b>	\$460	<i>East Timor</i>	\$840	Guyana (TC)	\$1,130
Burundi	\$100	Indonesia (TC)	\$1,420	Haiti	\$480
Cameroon	\$1,080	Kiribati	\$1,230	<b>Honduras (C)</b>	\$1,200
Central African Rep	\$360	Laos	\$500	<b>Nicaragua (C)</b>	\$1,000
Chad	\$480	<b>Mongolia (C)</b>	\$880	Paraguay (TC)	\$1,400
Comoros	\$660	Papua New Guinea	\$770		
Congo, Dem Rep of	\$130	<b>Philippines (TC)</b>	\$1,420		
Congo, Rep of	\$950	Solomon Islands	\$680		
Djibouti	\$1,060	<b>Vanuatu (C)</b>	\$1,710		
Eritrea	\$200	Vietnam	\$690		
Ethiopia	\$180				
Gambia	\$310				
Ghana (C)	\$520				
Guinea	\$410				
Guinea-Bissau	\$190	<b>South Asia</b>	<b>Income<sup>a</sup></b>	<b>Mid-East</b>	<b>Income<sup>a</sup></b>
Kenya (TC)	\$580	Afghanistan	<sup>b</sup>	Egypt	\$1,350
<b>Lesotho (C)</b>	\$1,030	Bangladesh	\$480	Iraq	<sup>b</sup>
Liberia	\$140	Bhutan	\$1,410	Yemen	\$760
<b>Madagascar (C)</b>	\$280	India	\$820		
<b>Malawi (TC)</b>	\$170	Nepal	\$290		
<b>Mali (C)</b>	\$440	Pakistan	\$770		
<i>Mauritania</i>	\$740	Sri Lanka	\$1,300		
<b>Mozambique (C)</b>	\$340				
Niger (TC)	\$260	<b>Eurasia</b>	<b>Income<sup>a</sup></b>		
Nigeria	\$640	<b>Georgia (C)</b>	\$1,560		
<i>Rwanda</i>	\$250	Kyrgyz Rep. (TC)	\$490		
Sao Tome&Principe (TC)	\$780	<b>Moldova (TC)</b>	\$1,100		
<b>Senegal</b>	\$750	Tajikistan	\$390		
Sierra Leone	\$240	Turkmenistan	<sup>b</sup>		
Somalia	<sup>b</sup>				
<b>Tanzania (C) (TC)</b>	\$350				
Togo	\$350				
Uganda (TC)	\$300				
Zambia (TC)	\$630				

a. Gross National Income, dollars per capita, 2006. World Bank, *World Development Indicators, On Line*.

b. Precise data unavailable.

**Table 3B. MCA Lower-Middle-Income Candidate and Eligible Countries — FY2008**

**Criteria:** Per capita income between \$1,735 and \$3,595, and not prohibited from receiving other U.S. economic assistance.

**Compact Eligible Countries** are in Bold

**Compact Countries** are followed with (C)

**Threshold Eligible Countries** are in Italics

**Threshold Program Countries** are followed with (TC)

<b>Africa</b>	<b>Income<sup>a</sup></b>	<b>East Asia/Pacific</b>	<b>Income<sup>a</sup></b>	<b>Latin America</b>	<b>Income<sup>a</sup></b>
Angola	\$1,980	Marshall Islands	\$3,000	Colombia	\$2,740
Cape Verde (C)	\$2,130	Micronesia	\$2,380	Dominican Rep	\$2,850
<b>Namibia</b>	\$3,230	Samoa	\$2,270	Ecuador	\$2,840
Swaziland	\$2,430	Tonga	\$2,170	<b>El Salvador(C)</b>	\$2,540
		Tuvalu	<sup>b</sup>	Guatemala	\$2,640
				Jamaica	\$3,480
				<i>Peru</i>	\$2,920
				Suriname	
		<b>South Asia</b>	<b>Income<sup>a</sup></b>	<b>Mid-East</b>	<b>Income<sup>a</sup></b>
		Maldives	\$2,680	Algeria	\$3,030
				<b>Jordan (TC)</b>	\$2,660
				<b>Morocco (C)</b>	\$1,900
				Tunisia	\$2,970
		<b>Eurasia</b>	<b>Income<sup>a</sup></b>	<b>Europe</b>	<b>Income<sup>a</sup></b>
		<b>Armenia (C)</b>	\$1,930	Albania (TC)	\$2,960
		Azerbaijan	\$1,850	Macedonia	\$3,060
		Belarus	\$3,380		
		<b>Ukraine (TC)</b>	\$1,950		

a. Gross National Income, dollars per capita, 2006. World Bank, *World Development Indicators On Line*.

b. Precise data unavailable. Montenegro figure is based on combined Serbia and Montenegro.



**Table 4. MCC Performance Indicators for FY2007**

<b>Ruling Justly</b>	<b>Investing in People</b>	<b>Economic Freedom</b>
<b>Control of Corruption</b> Source: World Bank Institute [ <a href="http://www.worldbank.org/wbi/governance">http://www.worldbank.org/wbi/governance</a> ]	<b>Public Primary Education Spending as % of GDP</b> Sources: UNESCO and National governments	<b>Inflation</b> Source: IMF World Economic Outlook
<b>Voice and Accountability</b> Source: World Bank Institute [ <a href="http://www.worldbank.org/wbi/governance">http://www.worldbank.org/wbi/governance</a> ]	<b>Primary Girls' Education Completion Rate</b> Source: UNESCO	<b>Fiscal Policy</b> Source: National governments and IMF World Economic Outlook
<b>Government Effectiveness</b> Source: World Bank Institute [ <a href="http://www.worldbank.org/wbi/governance">http://www.worldbank.org/wbi/governance</a> ]	<b>Public Expenditure on Health as % of GDP</b> Source: World Health Organization (WHO)	<b>Trade Policy</b> Source: The Heritage Foundation, Index of Economic Freedom [ <a href="http://www.heritage.org/research/features/index/">http://www.heritage.org/research/features/index/</a> ]
<b>Rule of Law</b> Source: World Bank Institute [ <a href="http://www.worldbank.org/wbi/governance">http://www.worldbank.org/wbi/governance</a> ]	<b>Immunization Rates: DPT and Measles</b> Source: World Health Organization (WHO)	<b>Regulatory Policy</b> Source: World Bank Institute [ <a href="http://www.worldbank.org/wbi/governance">http://www.worldbank.org/wbi/governance</a> ]
<b>Civil Liberties</b> Source: Freedom House [ <a href="http://www.freedomhouse.org/template.cfm?page=15&amp;year=2006">http://www.freedomhouse.org/template.cfm?page=15&amp;year=2006</a> ]	<b>Natural Resource Management: Eco-Region Protection, Access to Clean Water and Sanitation, Child Mortality</b> Sources: Columbia Center for Int'l Earth Science Info Network (CIESIN) and Yale Center for Env. Law and Policy (YCLEP)	<b>Business Start-Up: Days and Cost of Starting a Business</b> Source: World Bank [ <a href="http://www.doingbusiness.org">http://www.doingbusiness.org</a> ]
<b>Political Rights</b> Source: Freedom House [ <a href="http://www.freedomhouse.org/template.cfm?page=15&amp;year=2006">http://www.freedomhouse.org/template.cfm?page=15&amp;year=2006</a> ]		<b>Land Rights and Access</b> Source: Int'l Fund for Agricultural Development (IFAD) and Int'l Finance Corporation