

Guiding Principles for
Design and Implementation of the
Millennium Challenge Account

Nancy Birdsall, Sarah Lucas, Sonal Shah*

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

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

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

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

1. Ring-fence the MCA for development

MCA resources should be ring-fenced solely for development and used where they will be most effective in fostering development. In the interest of increasing overall aid effectiveness, the design and administration of the MCA should allow for flexibility and provide for the opportunity to learn and adapt the design over time. In doing so, the United States would take renewed leadership in the shaping of the international aid architecture, taking into account lessons learned from the past.

2. Focus on strengthening national institutions

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

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

3. Build in an easy exit mechanism for donors

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

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

4. Foster recipient country ownership

The evidence shows that foreign aid is most effective when it supports development strategies, policies and programs that are designed and implemented by leadership in the country receiving the aid, and politically supported and thus sustained by that country's citizens and business and political communities. The MCA should be designed to reinforce this principle, by supporting country-based programs such as the World Bank Poverty Reduction Strategy Paper (PRSP) process, which build in country-designed development strategies, performance benchmarks, and accountability mechanisms.

5. Encourage competition

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

6. Insist on full public disclosure

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

7. Complement existing frameworks

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

Appendix

Millennium Challenge Account One Approach For Design and Implementation*

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

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

Step 1. Identify eligible countries based on their meeting a minimum threshold of eligibility, using simple and clear standards. This step is binary in nature – a country falls in one of two categories, eligible or not.

Step 2. Invite eligible countries to participate in a competitive process to receive 2-3 year grants. Selection in this step is not ‘all or nothing’, but could include a continuum of support based on the technical quality of proposals.

Step 1: Country Eligibility

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

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

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

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

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

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

Step 2: Competitive Program Selection*

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

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

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

Technical Advisory Board(s)

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

Inherent Trade-Offs

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

- First, there is a trade-off between the “**fairness**” of a rules-based system, in which strict and explicit criteria are applied across all countries with no deviation, on the one hand, and the **flexibility** to respond to unique and dynamic country conditions with a fully discretionary approach, on the other. Although both approaches involve politics and negotiation, the rules-based system restricts political influence to the establishment of criteria, whereas the discretionary approach is subject to political forces all the way up to the moment of determining country eligibility. *To achieve the aims of the MCA, we recommend a system that is significantly more transparent than current aid mechanisms, and that sends clear signals to countries regarding what is required to achieve and maintain eligibility for funding – that is, a primarily rules-based approach, using a combination of qualitative and quantitative criteria.* In the first stage of the funding decision, a clear “yes/no” decision about which countries meet a

minimum threshold for consideration, based on straightforward criteria, permits a healthy competitive process among program proposals during a second stage. In that second stage, programs can be compared on the basis of technical soundness, without the confounding factor of the overall country environment.

- Second, there is a trade-off between the **simplicity** of applying a small number of indicators that are clearly defined and reasonably measurable, and the **ability to make fine distinctions** that would be possible with a larger number of highly nuanced indicators. For example, the selection of “gross primary school enrollment rate” as an indicator for “investing in people” might have the advantage of being relatively simple and measurable, but might not capture the concept of “investing in people” as well as a combination of more complex measures of teacher preparation, school quality and gender balance in education. In deciding among these options, it is useful to remember that combining multiple measures in a meaningful way to arrive at binary (“yes/no”) decisions about country eligibility is complex, and invites lobbying among various interest groups about which criteria should be weighed more or less heavily in the final decision. *To meet the aims of the MCA, we recommend that the indicators be restricted to a very small number (a handful or fewer) that correspond well to widely accepted indicators; and that clear decision rules be established ex ante.* We also recommend that a country would have to fully meet all the criteria in each area (ruling justly, economic freedom and investing in people) to be deemed eligible.
- Third, there is a tradeoff between establishing very demanding thresholds for the indicators, which will lead to the **exclusion of a large number of countries**, and establishing more generous thresholds that will lead to **the inclusion of a large number of countries**. For example, if countries must demonstrate very high levels of achievement in the areas of ruling justly, economic freedom and investing in people, then it is likely that a very small number of the IDA-eligible countries would qualify. If, however, the thresholds are less strict, a correspondingly broader number of countries would be eligible for the competition for funding of their programs. The question of whether to go for broad or narrow eligibility is related to two issues: First is the extent to which the MCA seeks to learn through funding programs in a variety of social, political and economic contexts. If a relatively diverse experience is desired, this implies more generous eligibility criteria. Second is the practical question of managing the second-stage review process for the detailed proposals for funding. It is likely that review of a large number of proposals will be slow and cumbersome, and defeat the MCA intention of being a streamlined mechanism for aid delivery. On the other hand, too-narrow country eligibility could undermine the value of competition at the program selection stage. In practice, it is likely that setting the precise thresholds for quantitative criteria will involve some empirical testing to see how many countries are included or excluded at different threshold levels. *On balance, we recommend that the criteria be established at a threshold levels that*

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

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

Ensuring and Evaluating Effectiveness

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

