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MILLENNIUM
CHALLENGE
CORPORATION

Progress Made on Key
Challenges in First Year of
Operations

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MILLENNIUM CHALLENGE CORPORATION

Progress Made on Key Challenges in First Year of Operations

Highlights of [GAO-05-625T](#), testimony before the House International Relations Committee

Why GAO Did This Study

In January 2004, Congress established the Millennium Challenge Corporation (MCC) to administer the Millennium Challenge Account. MCC's mission is to promote economic growth and reduce extreme poverty in developing countries. The act requires MCC to rely to the maximum extent possible on quantitative criteria in determining countries' eligibility for assistance. MCC will provide assistance primarily through compacts—agreements with country governments. MCC aims to be one of the top donors in countries with which it signs compacts.

For fiscal years 2004 and 2005, Congress appropriated nearly \$2.5 billion for the Millennium Challenge Corporation; for fiscal year 2006, the President is requesting \$3 billion. GAO was asked to monitor MCC's (1) process for determining country eligibility, (2) progress in developing compacts, (3) coordination with key stakeholders, and (4) establishment of management structures and accountability mechanisms.

What GAO Recommends

GAO recommends that MCC's Chief Executive Officer continue to develop and implement overall plans and related time frames to establish corporatewide accountability, internal control, and human capital management. In addition, GAO recommends that MCC's Board of Directors consider, in addition to its statutory responsibilities, other responsibilities associated with sound and effective governance.

www.gao.gov/cgi-bin/getrpt?GAO-05-625T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David B. Gootnick at (202) 512-4128 or gootnickd@gao.gov.

What GAO Found

For fiscal years 2004 and 2005, the MCC board used the quantitative criteria as well as judgment in determining 17 countries to be eligible for MCA compacts. Although MCC chose the indicators based in part on their public availability, our analysis showed that not all of the source data for the indicators were readily accessible. In addition, we found that reliance on the indicators carried certain inherent limitations, such as measurement uncertainty.

Between August 2004 and March 2005, MCC received compact proposals, concept papers, or both, from 16 eligible countries. It signed a compact with Madagascar in April 2005 and is negotiating compacts with four countries. MCC's 4-year compact with Madagascar for \$110 million would make it the country's fifth largest donor. MCC is continuing to refine its compact development process. In addition, MCC has identified elements of program implementation and fiscal accountability that can be adapted to eligible countries' compact objectives and institutional capacities.

MCC is taking steps to coordinate with key stakeholders to use existing expertise and conduct outreach. The U.S. agencies on the MCC Board of Directors—USAID, the Departments of State and Treasury, and the Office of the U.S. Trade Representative—have provided resources and other assistance to MCC, and five U.S. agencies have agreed to provide technical assistance. Bilateral and multilateral donors are providing information and expertise. MCC is also consulting with nongovernmental organizations in the United States and abroad as part of its outreach activities.

MCC has made progress in developing key administrative infrastructures that support its mission and operations. MCC has also made progress in establishing corporatewide structures for accountability, governance, internal control, and human capital management, including establishing an audit capability through its Inspector General, adopting bylaws, providing ethics training to employees, and expanding its permanent full-time staff. However, MCC has not yet completed comprehensive plans, strategies, and related time frames for establishing these essential management structures and accountability mechanisms on a corporatewide basis.

Selected Elements of MCC Progress as of April 2005

Compact-related activities	2004					2005					Total as of Apr. '05
	Feb.	May	Aug.	Nov.	Feb.	May	Aug.	Nov.	Feb.		
Eligible countries		16 for FY04					16 for FY05				17
• Submitted proposals				16 received							16
• In compact negotiations							4				4
• Compact signed									1		1
Resources											
Number of employees		22	43	64	94	107					107
Funds appropriated	\$1 billion			\$1.5 billion							\$2.5 billion

Source: GAO.

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss GAO's findings and observations regarding the Millennium Challenge Corporation's (MCC) first year of operations.

In January 2004, Congress established MCC,¹ a government corporation, to administer the Millennium Challenge Account (MCA). MCC's mission is to provide development assistance that reduces extreme poverty through economic growth and strengthens good governance, economic freedom, and investments in people. MCC is to carry out its mission by funding projects or activities in developing countries that demonstrate a commitment to MCA objectives. MCC assistance is intended to supplement existing development assistance provided by the United States or other donors; to provide incentive, MCC aims to be among countries' largest donors. The Millennium Challenge Act of 2003 authorizes assistance in the form of grants, cooperative agreements, and contracts, which MCC will administer through compacts—agreements between the U.S. government and recipient countries' governments. Candidate countries are expected to develop compact proposals to secure MCA funding and manage MCC-funded projects.

The act requires the MCC Board of Directors to determine a country's eligibility for assistance, based, to the maximum extent possible, on objective and quantifiable indicators of the country's commitment to specific criteria set out in the act.² MCC is also required to provide to Congress justifications for the board's eligibility determinations and to coordinate its activities with those of the U.S. Agency for International Development (USAID). The act also authorizes MCC to help certain candidate countries achieve eligibility, which MCC does through its

¹Millennium Challenge Act of 2003, Public Law 108-199, Division D, Title VI of the Consolidated Appropriations Act, 2004. Also, Title II, Division D of this act established the Millennium Challenge Account for MCC appropriations.

²For fiscal years 2004 and 2005, MCC established an eligibility methodology that rates countries on 16 indicators, which are selected in part based on their objectivity and public availability. The indicators are arranged under the three policy categories—Ruling Justly, Investing in People, and Encouraging Economic Freedom. To be eligible, countries must score above the median on at least half of the indicators in each category and above the median on an indicator for combating corruption.

Threshold Program.³ For fiscal years 2004 and 2005, Congress appropriated nearly \$1 billion and \$1.5 billion, respectively, for MCC; for fiscal year 2006, the President is requesting \$3 billion.

Today I will discuss MCC's activities during its first 15 months, specifically, its (1) process for determining country eligibility for fiscal years 2004-2005, (2) progress in developing compacts, (3) coordination with key stakeholders, and (4) establishment of management structures and accountability mechanisms.

To address these objectives, GAO analyzed MCC's process for determining country eligibility, including countries' scores for the quantitative indicators and the scores' source data for fiscal years 2004 and 2005; we also examined the selection criteria for the Threshold Program. We determined that these and other data that we used were sufficiently reliable for our analysis. In addition, we reviewed MCC documents, countries' compact proposals and an MCC compact, and reports by USAID and GAO. We conducted interviews with, among others, officials from MCC, U.S. government agencies, and nongovernmental organizations (NGOs), and we attended MCC public outreach meetings in Washington, D.C. In January 2005, we visited Honduras, one of four countries with which MCC was negotiating at that time, where we met with officials from the Department of State, USAID, MCC, and the Honduran government, as well as donor representatives and local NGOs. We performed our work between April 2004 and April 2005 in accordance with generally accepted government auditing standards. (See app. I for further details of our scope and methodology.)

Summary

The MCC Board of Directors based its determinations of countries' eligibility for MCA assistance on a quantitative indicator methodology, as required by the Millennium Challenge Act; at the same time, the process involved certain challenges. Applying its 16 quantitative indicators and exercising the discretion implicit in the act, the board selected a total of 17 countries as eligible for compact assistance for fiscal years 2004 and 2005. MCC did not provide Congress its justifications for the 13 countries that met the indicator criteria but were not deemed eligible; the Millennium

³The Threshold Program provides assistance to improve scores on the 16 indicators for candidate countries that are not deemed eligible but demonstrate a significant commitment to meeting MCC eligibility requirements.

Challenge Act does not require MCC to provide justifications for not selecting countries. In addition, although MCC published country scores for the 16 indicators at its Web site, some of the source data used to generate these scores were not readily available to the public. Our analysis of the results of MCC's eligibility determinations also revealed some inherent limitations of MCC's indicator methodology. For instance, measurement uncertainty may have affected the eligibility determination for 17 countries, and missing data for two indicators may have reduced the number of countries that passed the Economic Freedom category.

MCC is refining the compact development process and has taken steps to identify country-level program implementation and fiscal accountability elements. Between August 2004 and March 2005, MCC received compact proposals, concept papers, or both, from 16 eligible countries. It signed a 4-year compact with Madagascar for \$110 million in April 2005 and is negotiating compacts with 4 other countries. MCC's compact with Madagascar would make it the country's fifth largest donor. MCC's compact development process currently involves the following steps: (1) proposal development, (2) proposal submission and initial assessment, (3) detailed proposal assessment and negotiation, and (4) board review and compact signing. In addition, MCC has identified elements of a program implementation and fiscal accountability framework that can be adapted to eligible countries' compact objectives and institutional capacities.

MCC has initiated coordination of program activities with U.S. agencies, other donors, and U.S.-based NGOs. U.S. agencies represented on the MCC Board of Directors—USAID, the Departments of State and Treasury, and the Office of the U.S. Trade Representative (USTR)—have provided advice, resources, and assistance to MCC. In addition, MCC has signed agreements with five U.S. agencies for programmatic and technical assistance. Key bilateral and multilateral donors are providing information and expertise, such as country briefings and assessments, to MCC. In addition, MCC is consulting with some U.S.-based NGOs and has met with country-based NGOs. However, several U.S.-based NGOs have raised questions about the involvement of U.S.-based NGOs and country-based civil society groups.

MCC has made progress in establishing key management structures and elements of accountability mechanisms, but it has not yet developed essential corporatewide plans, strategies, and time frames. MCC's accomplishments in its first 15 months included setting up key administrative infrastructures to support its initial and ongoing program

implementation, establishing an audit and review capability through its Inspector General (IG), adopting bylaws for its Board of Directors, providing ethics training to employees, and expanding its permanent full-time staff. However, MCC has not yet completed the plans, strategies, and time frames needed to establish corporatewide structures for accountability, governance, internal control, and human capital management. For example, the MCC board has not fully defined its responsibilities for overseeing corporate management, and MCC management has not yet completed its institutional infrastructure that aligns human capital planning and performance management with the corporation's goals and mission.

We recommend that MCC's Chief Executive Officer continue to develop and complete overall plans and related time frames to address corporatewide accountability, establish comprehensive internal control over program and administrative operations, and institute an effective human capital infrastructure. In addition, we recommend that the Secretary of State, in her capacity as Chair of the MCC Board of Directors, ensure that the board considers and defines the scope of its responsibilities with respect to corporate governance and oversight and develops an overall plan or strategy, with related time frames, for carrying out these responsibilities. In doing so, the board should consider, in addition to its statutory responsibilities, other corporate governance and oversight responsibilities commonly associated with sound and effective corporate governance practices. MCC provided technical comments on a draft of this report and agreed to take our recommendations under consideration.

Background

Each fiscal year, the Millennium Challenge Act requires MCC to select countries as eligible for MCA assistance by identifying candidate countries, establishing an eligibility methodology, and making eligibility determinations. MCC evaluates eligible countries' proposals and negotiates compacts, which must be approved by the MCC board. The Threshold Program assists countries that are not deemed eligible but show a commitment to MCA objectives. MCC is governed by a board of directors consisting of U.S. government and other representatives.

Candidate Countries

For fiscal year 2004, the Millennium Challenge Act limited candidates to low-income countries—those with per capita incomes less than or equal to the International Development Association (IDA) cutoff for that year (\$1,415)—that also were eligible for IDA assistance.⁴ This provision limited candidacy in the MCA’s first year to the poorest low-income countries. For fiscal year 2005, candidates were required only to have incomes less than or equal to the IDA ceiling for that year (\$1,465).⁵ Additionally, for fiscal years 2004 and 2005, candidates could not be ineligible for U.S. economic assistance under the Foreign Assistance Act of 1961. (See app. II for a list of candidate countries for fiscal years 2004 and 2005.)

Eligibility Determinations

The Millennium Challenge Act requires that the MCC board base its eligibility decisions, “to the maximum extent possible,” on objective and quantifiable indicators of a country’s demonstrated commitment to the criteria enumerated in the act. MCC selected its indicators based on their relationship to growth and poverty reduction, the number of countries they cover, their transparency and public availability, and their relative soundness and objectivity.⁶

For fiscal years 2004 and 2005, MCC’s process for determining country eligibility for MCA assistance had both a quantitative and a discretionary component (see fig. 1). MCC first identified candidate countries that performed above the median in relation to their peers on at least half of the quantitative indicators in each of the three policy categories—Ruling Justly, Investing in People, and Encouraging Economic Freedom—and above the median on the indicator for control of corruption. (See app. III for a table describing the indicators, listing their sources, and summarizing the methodologies on which they are based.) In addition, MCC considered

⁴The IDA, an arm of the World Bank Group, provides long-term interest-free loans and grants to the poorest developing countries with limited access to private sources of capital.

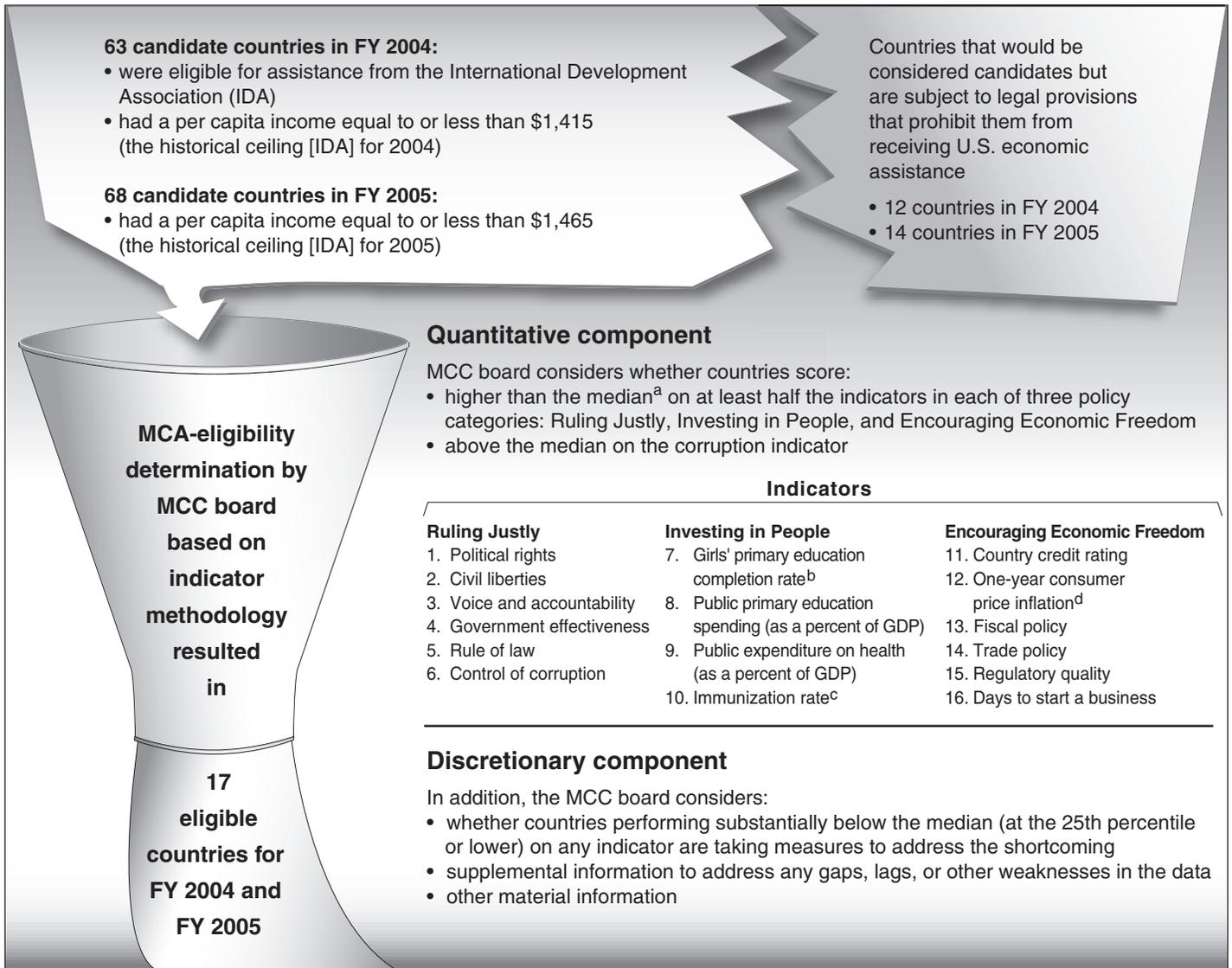
⁵For fiscal year 2006 and beyond, the Millennium Challenge Act requires that candidates for MCA assistance (1) be either low-income or lower-middle-income countries and (2) not be ineligible for U.S. economic assistance under the Foreign Assistance Act of 1961. The act defines lower-middle-income countries as those classified as such by the World Bank with incomes above the IDA ceiling. MCA assistance to the lower-middle-income countries may not exceed 25 percent of the total amount of assistance to all countries for that year.

⁶See Millennium Challenge Corporation, “Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in FY 2004, Annex A: Indicator Definitions” (available at: http://www.mca.gov/about_us/congressional_reports/index.shtml).

other relevant information—in particular, whether countries that scored substantially below the median (at the 25th percentile or lower) on an indicator were addressing any shortcomings related to that indicator. MCC also considered supplemental information to address gaps, lags, or other data weaknesses as well as additional material information.⁷

⁷MCC's fiscal year 2004 and 2005 methodology reports state that, where the act stipulates criteria for which there is limited quantitative information (e.g., rights of people with disabilities) or no well-developed performance indicator (e.g., sustainable management of natural resources), the MCC board relies on supplemental data and qualitative information such as State Department Human Rights reports, access to sanitation, deforestation, and trade in endangered species.

Figure 1: MCC's Process for Determining Country Eligibility



Source: GAO analysis of MCC selection process.

^aThe fiscal year 2004 and 2005 medians for the 16 indicators were based on the scores of all countries meeting the income criteria, including those countries that are ineligible to receive U.S. economic assistance under the Foreign Assistance Act.

^bFor fiscal year 2004, MCC used the Primary Education Completion Rate.

^cAverage of immunization rates for DPT3—diphtheria, pertussis and tetanus—and measles.

^dFor the consumer price inflation indicator, countries are not required to score higher than the median; instead, inflation rates must not exceed 20 percent for fiscal year 2004 or 15 percent for fiscal year 2005.

The Millennium Challenge Act requires that, within 5 days of the board's eligibility determinations, the MCC Chief Executive Officer submit a report to congressional committees containing a list of the eligible countries and "a justification for such eligibility determination" and publish the report in the *Federal Register*.

MCA Compacts

Eligible countries are invited to submit compact proposals, which are to be developed in consultation with members of civil society, including the private sector and NGOs. However, a country's eligibility does not guarantee that MCC will sign and then fund a compact with that country. MCC is to sign compacts only with national governments.⁸ Under the act, the duration of compacts is limited to a maximum of 5 years; MCC expects to approve compacts with durations of 3 to 5 years. MCA funds are not earmarked for specific projects or countries, and money not obligated in the fiscal year for which it was appropriated can be used in subsequent fiscal years. For fiscal years 2004 and 2005, Congress has directed that MCC use its existing appropriations to fully fund a compact—that is, obligate the entire amount anticipated for the compact's duration.⁹ Funding for compacts and the Threshold Program must be drawn from the appropriation for the fiscal year in which the country was eligible. MCC aims to be among the largest donors in recipient countries, which, according to MCC officials, creates incentive for eligible countries to "buy into" MCC's principles of policy reform, sustainable economic growth, country partnership, and results.

Threshold Program

The Millennium Challenge Act authorizes a limited amount of assistance to certain candidate countries to help them become eligible for MCA assistance. These candidate countries must (1) meet the fiscal year 2004 or 2005 requirements for MCA candidacy and (2) demonstrate a significant commitment to meeting the act's eligibility criteria but fail to meet those

⁸The Millennium Challenge Act authorizes assistance to the national government of an eligible country, regional or local governmental units of the country, or a nongovernmental organization or private entity.

⁹The Consolidated Appropriations Act, 2005, provides that funds appropriated for MCC for fiscal years 2004 and 2005 are available for compacts only if the compacts obligate, or commit to obligate (subject to availability of funds and agreement of the parties), the entire amount anticipated for the compact's duration. See Public Law 108-447, Division D, Title II, 118 Stat. 2809, 2980.

requirements.¹⁰ MCC has implemented these legislative provisions as its Threshold Program. Figure 2 compares features of MCC compact and Threshold Program assistance; appendix IV describes the Threshold Program.

Figure 2: Comparison of MCC Compact Assistance and Threshold Program

	MCC compact assistance	Threshold Program
Program goal	Poverty reduction through economic growth.	Improvement in eligibility indicators that are central to MCC's selection methodology. ^a
Total funding available	\$954 million in FY 2004 and \$1.35 billion in FY 2005. ^b	\$40 million in FY 2004 and up to \$150 million in FY 2005. ^c
Application deadline	No deadline for concept paper or proposal submission.	Concept papers due by January 31, 2005 for FY 2004 and March 15, 2005 for FY 2005; no deadline for detailed plan.
Proposal development	Consultative process involving civil society organizations, private sector, etc., is required.	No consultative process required.
Program duration	Approved compacts to be funded for up to 5 years.	Approved threshold plans will be funded for up to 2 years, though exceptions may be made.
Program management	Country oversight entity will be accountable to MCC.	USAID will manage Threshold Program with MCC oversight.
Country role	Countries propose economic development and poverty reduction priorities and negotiate compacts with MCC.	Countries are expected to propose programs that address weaknesses that may have caused them to fail the eligibility indicators.

Source: GAO synthesis of MCC information.

^aAccording to MCC, participation in the Threshold Program does not guarantee future eligibility for compact assistance.

^bIncludes funds for administrative expenses but excludes \$40 million set aside for fiscal year 2004 and \$150 million (up to 10 percent of total MCC appropriations) in fiscal year 2005 for the Threshold Program. As of April 2005, MCC had not determined the amount of funding set aside for the fiscal year 2005 Threshold Program.

^cThe MCC board could authorize additional Threshold Program funding of up to 10 percent (\$99.4 million) of fiscal year 2004 MCC appropriations.

¹⁰The act limited this type of assistance to 10 percent of MCA's fiscal year 2004 appropriations. The Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2005, limited this type of assistance to 10 percent of fiscal year 2005 appropriations. Future funding for this type of assistance will be determined by legislation in subsequent years.

MCC Governance

MCC has broad authority under the Millennium Challenge Act to enter into contracts and business relationships. The act establishes the MCC Board of Directors and assigns it a key decision-making role in the corporation's activities, including those related to implementing the compact program. The act also makes provisions for the board to consult with Congress and provide general supervision of MCC's IG.¹¹ The board consists of the Secretary of State (Board Chair), the Secretary of the Treasury (Vice Chair), the USAID Administrator, and the U.S. Trade Representative, in addition to MCC's Chief Executive Officer. The board has four other positions filled by Presidential appointment with the approval of the Senate. Two of these positions have been filled. (For a timeline of key events and milestones since MCC's launch, see app. V.)

MCC Used Quantitative Indicators and Judgment to Determine Country Eligibility; Process Involves Ongoing Challenges

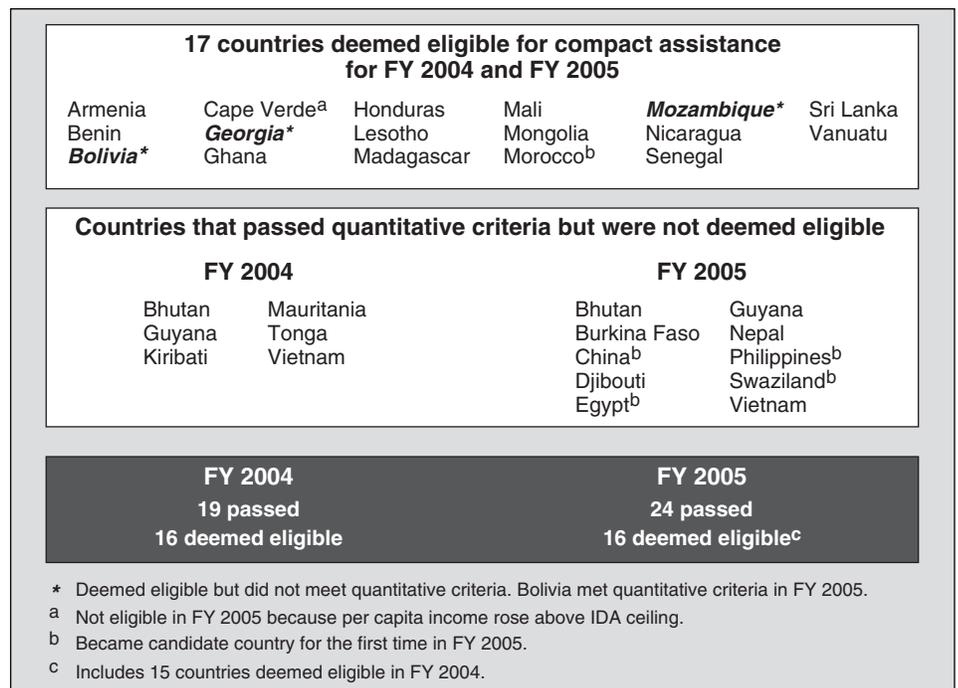
For fiscal years 2004 and 2005, the MCC board based its determinations of countries' eligibility on its quantitative indicator methodology as well on discretion. Although MCC published the countries' indicator scores at its Web site, some of the indicator source data used to generate the scores were not readily available. Finally, we found that reliance on the indicators carried certain inherent limitations.

¹¹Public Law 108-199 designated the USAID Office of the Inspector General as MCC's IG.

MCC Used Quantitative Indicators and Judgment to Determine Eligibility

MCC used the 16 quantitative indicators, as well as the discretion implicit in the Millennium Challenge Act, to select 17 countries as eligible for MCA compact assistance for fiscal years 2004 and 2005 (see fig. 3).

Figure 3: MCA Eligibility Determinations for Fiscal Years 2004 and 2005



Source: GAO analysis of MCC data.

- Fiscal year 2004:** In May 2004, the MCC board selected 16 countries as eligible for fiscal year 2004 funding. The countries deemed eligible include 13 that met the quantitative indicator criteria and 3 that did not (Bolivia, Georgia, and Mozambique). Another 6 countries met the criteria but were not deemed eligible.
- Fiscal year 2005:** In October 2004, the MCC board selected 16 countries as eligible for fiscal year 2005 funding. The countries deemed eligible included 14 countries that met the indicator criteria and 2 countries that did not (Georgia and Mozambique). Ten countries met the criteria but were not deemed eligible. Fifteen of the 16 countries

also had been deemed eligible for fiscal year 2004;¹² the only new country was Morocco.

MCC did not provide Congress its justifications for the 13 countries that met the indicator criteria but were not deemed eligible for fiscal years 2004 and 2005 (one of these countries, Tonga, did not score substantially below the median on any indicator).¹³ The act does not explicitly require MCC to include a justification to Congress for why these countries were not deemed eligible.

In addition, our analysis of countries that met the indicator criteria but were not deemed eligible suggests that, besides requiring that a country score above the median on the indicator for control of corruption, MCC placed particular emphasis on three Ruling Justly indicators (political rights, civil liberties, and voice and accountability) in making its eligibility determinations. In fiscal years 2004 and 2005, 6 of the 13 countries that met the indicator criteria but were not deemed eligible had scores equal to or below the median on these three indicators.¹⁴ On the other hand, the 13 countries that were not deemed eligible performed similarly to the eligible countries on the other three Ruling Justly indicators—government effectiveness, rule of law, and control of corruption—as well as on the indicators for Investing in People and Encouraging Economic Freedom.

¹²Cape Verde, eligible in fiscal year 2004, was not a candidate in fiscal year 2005.

¹³According to GAO analysis, 12 of the countries deemed eligible in fiscal years 2004 and 2005 met the indicator criteria but scored substantially below the median (25th percentile or lower) on one or two indicators. MCC's reports to Congress listed 4 countries that scored substantially below the median (Cape Verde, Lesotho, Morocco, and Sri Lanka). MCC provided justification for selecting as eligible these 4 countries, but it did not provide justification for selecting the remaining 8 countries.

¹⁴The 6 countries that scored low on the three governance indicators are Bhutan, China, Djibouti, Egypt, Swaziland, and Vietnam. The 13 countries that passed the indicators but were not selected are Bhutan (2004 and 2005), Burkina Faso (2005), China (2005), Djibouti (2005), Egypt (2005), Guyana (2004 and 2005), Kiribati (2004), Mauritania (2004), Nepal (2005), Philippines (2005), Swaziland (2005), Tonga (2004), and Vietnam (2004 and 2005). Six of these countries—China, Djibouti, Egypt, Nepal, Swaziland, and Vietnam—also scored low on trade policy relative to the MCA-eligible countries.

Not All Source Data for Quantitative Indicators Were Publicly Accessible

Although MCC published its country scores for all of the indicators at its Web site,¹⁵ some of the indicator source data used to generate the scores were not readily available to the public. We found that source data for nine of the indicators¹⁶ were accessible via hyperlinks from MCC's Web site, making it possible to compare those data with MCC's published country scores. However, for the remaining seven indicators, we encountered obstacles to locating the source data, without which candidate countries and other interested parties would be unable to reproduce and verify MCC's results.

- **Primary education completion rates:** The published indicators were created with data from several sources and years, and not all of these data were available on line.
- **Primary education and health spending (percentage of gross domestic product):** When national government data were unavailable, MCC used either country historical data or data from the World Bank to estimate current expenditures.
- **Diphtheria and measles immunization rate:** The general hyperlink at the MCC Web site did not link to the data files used to create the published indicators.¹⁷
- **One-year consumer price inflation:** The published indicators were created with a mix of data from several data sources and different years.
- **Fiscal policy:** The published indicators were created with International Monetary Fund (IMF) data that are not publicly available.

¹⁵MCC officials told us that, owing to staffing constraints, MCC did not post updated indicator data before the board's fiscal year 2004 eligibility decisions. Having added more staff, MCC posted the updated data prior to the board's fiscal year 2005 decisions.

¹⁶Source data for voice and accountability, government effectiveness, rule of law, control of corruption, and regulatory quality were from the World Bank Institute; for trade policy, from the Heritage Foundation; for civil liberties and for political rights, from Freedom House; and for country credit rating, from Institutional Investor.

¹⁷MCC officials told us that they use general hyperlinks to prevent users from linking to outdated Web addresses.

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- **Days to start a business:** Updated indicators were not published until after the board had made its fiscal year 2004 eligibility decisions.

Use of Quantitative Indicators Had Some Inherent Limitations

MCC's use of the quantitative indicator criteria in the country selection process for fiscal years 2004 and 2005 involved the following inherent difficulties:

- Owing to measurement uncertainty, the scores of 17 countries may have been misclassified as above or below the median.¹⁸ In fiscal years 2004 and 2005, 7 countries did not meet the quantitative indicator criteria because of corruption scores below the median, but given measurement uncertainty their true scores may have been above the median. Likewise, 10 countries met the indicator criteria with corruption scores above the median, but their true scores may have been below the median.¹⁹
- Missing data for the days to start a business and trade policy indicators reduced the number of countries that could achieve above-median scores for those indicators. For fiscal years 2004 and 2005, 20 and 22 countries, respectively, lacked data for the indicator for days to start a business, and 18 and 13 countries, respectively, lacked data for the trade policy indicator. Our analysis suggests that missing data for these two indicators may have reduced the number of countries that passed the Encouraging Economic Freedom category.
- The narrow and undifferentiated range of possible scores for the political rights, civil liberties, and trade policy indicators led to clustering—"bunching"—of scores around the median, making the scores less useful in distinguishing among countries' performances. In fiscal year 2005, for example, 46 countries, or two-thirds of the

¹⁸Measurement uncertainty, or margin of error, makes it difficult in many cases to say with accuracy where a country's true score lies. Measurement uncertainty applies to virtually all indicators, including the World Bank Institute's governance indicators. The World Bank team that created the corruption and other governance indicators cautioned that special scrutiny should be given to borderline cases, saying that "for one-third of the potentially MCA-eligible countries, there is at least a 25 percent chance they will be mistakenly classified as below the median when they should be above, and vice versa." See Daniel Kaufmann and Aart Kraay, *Governance Indicators, Aid Allocation, and the Millennium Challenge Account: A Summary* (Washington, D.C.: The World Bank, December 2002).

¹⁹According to MCC officials, the board also used Transparency International's (TI) Corruption Perceptions Index as a secondary corruption source. However, TI scores were not available for all the fiscal years 2004 and 2005 candidate countries.

countries with trade policy data, received a score of 4 (the median) or 5 (the lowest score possible) for trade policy. Our analysis suggests that bunching potentially reduced the number of countries that passed the Ruling Justly and Economic Freedom categories and limited MCC's ability to determine whether countries performed substantially below their peers in affected indicators.

With respect to the indicator for control of corruption, countries deemed eligible for MCA compact assistance represent the best performers among their peers; at the same time, studies have found that, in general, countries with low per capita income also score low on corruption indexes. Of the 17 MCA compact eligible countries, 11 ranked below the 50th percentile among the 195 countries rated by the World Bank Institute for control of corruption; none scored in the top third.

MCC Is Refining Its Compact Development Process

MCC has received compact proposals, concept papers, or both, from 16 countries; of these, it has approved a compact with one country and is negotiating with four others. At the same time, MCC continues to refine its process for reviewing and assessing compact proposals. As part of this process, MCC has identified elements of country program implementation and fiscal accountability that can be adapted to eligible countries' compact objectives and institutional capacities.

MCC Has Received a Number of Proposals and Is Negotiating Several Compacts

Between August 2004 and March 2005, MCC received compact proposals, concept papers, or both, from 16 MCA compact-eligible countries, more than half of which submitted revised proposal drafts in response to MCC's assessments.²⁰ In March 2005, MCC approved a 4-year compact with Madagascar for \$110 million to fund rural projects aimed at enhancing land titling and security, increasing financial sector competition, and improving agricultural production technologies and market capacity; MCC and Madagascar signed the compact on April 18, 2005. MCC is negotiating compacts with Cape Verde, Georgia, Honduras, and Nicaragua²¹ and is conducting in-depth assessments of proposals from two additional countries. Figure 4 summarizes the types of projects that eligible countries have proposed and that MCC is currently reviewing.

²⁰MCC encourages countries to submit concept papers, outlines, or other documentation for guidance and feedback before submitting initial proposals.

²¹MCC has notified appropriate congressional committees of its intent to enter into negotiations with these countries.

Figure 4: Types of Proposed Projects under MCC Review

	Agribusiness ^a	Business ^b	Education and health	Energy	Finance and credit	Land titling	Policy reform ^c	Transportation infrastructure ^d	Water management ^e	Water sanitation
Armenia	•						•	•		
Benin	•				•	•	•			
Bolivia		•	•	•			•		•	
Cape Verde	•	•	•	•		•	•	•		
Georgia	•	•	•	•			•	•	•	
Ghana	•			•	•	•	•	•		
Honduras	•			•		•	•			
Lesotho						•		•		
Madagascar ^f	•			•	•	•				
Mali	•						•	•		
Mongolia		•	•	•			•			
Mozambique	•	•	•	•	•	•	•		•	
Nicaragua	•	•	•	•	•	•	•	•		
Senegal		•		•			•			
Sri Lanka		•	•	•		•	•	•	•	
Vanuatu						•	•			

Source: GAO summary and analysis of MCC data as of April 20, 2005.

Note: Dots indicate that one or more projects may be categorized as shown and are not intended to quantify the number of projects a country has proposed or the number of projects in a category.

^a“Agribusiness” includes agricultural production, processing, marketing, and other projects.

^b“Business” includes projects related to nonagricultural business development (e.g., tourism and industrial parks).

^c“Policy reform” also includes assistance for public sector capacity-building. According to MCC officials, all compacts will contain project-related policy reform elements, some of which may receive funding.

^d“Transportation infrastructure” includes road, port, and airport planning, construction, and upgrading.

^e“Water management” includes construction and upgrading of dams, irrigation systems, and water reservoirs, among other things.

^fMCC approved Madagascar’s compact in March 2005; MCC and Madagascar signed the compact on April 18, 2005.

The countries' initial proposals and concept papers requested about \$4.8 billion; those that MCC is currently reviewing (see fig. 4) and negotiating request approximately \$3 billion over 3 to 5 years. Our analysis—based on MCC's goal of being a top donor as well as Congress's requirement that the corporation fund compacts in full—shows that the \$2.4 billion available from fiscal year 2004 and 2005 appropriations will allow MCC to fund between 4 and 14 compacts, including Madagascar's compact, for those years.²² MCC's \$110 million compact with Madagascar, averaging \$27.5 million per year, would make it the country's fifth largest donor (see app. VI for a list of the largest donors to MCA compact-eligible countries in fiscal years 2002-2003).²³

MCC Continues to Refine Its Compact Development Process

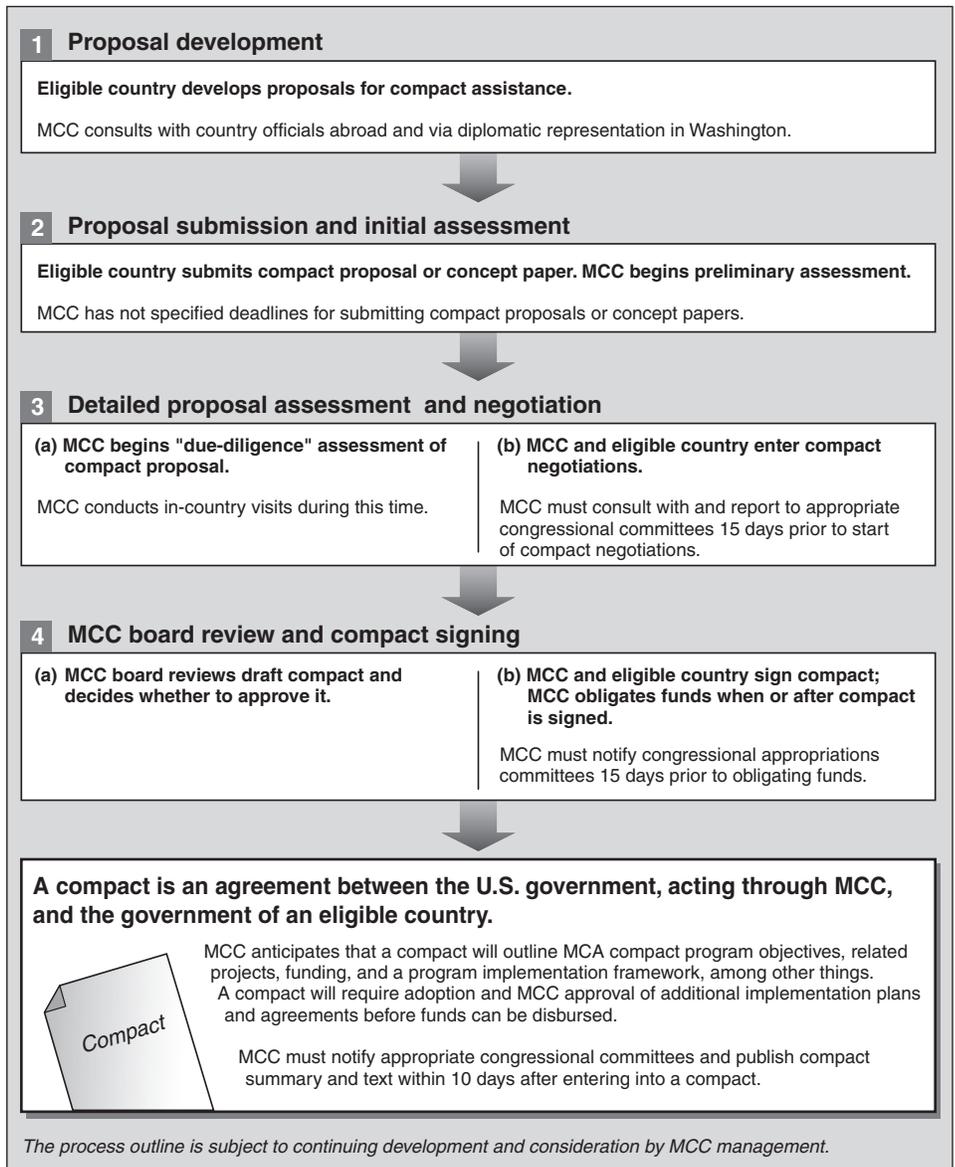
As of April 2005, MCC is continuing to refine its process for developing compacts. According to MCC officials, the compact development process is open ended and characterized by ongoing discussions with eligible countries. According to a recent IG report, MCC's negotiating a compact with Madagascar has served as a prototype for completing compacts with other countries.²⁴ At present, the compact proposal development and assessment process follows four steps (see fig. 5).

²²The lower estimated number of compacts assumes that MCC funds 5-year compacts at a level equal to the average annual assistance provided by the largest donor in the 17 countries that were eligible in fiscal years 2004 and 2005 (about \$109 million). The higher estimate assumes that MCC funds 3-year compacts at a level equal to the average annual assistance provided by the third largest donor in these countries (about \$60 million).

²³Based on OECD net official development assistance (ODA) data. OECD defines ODA as grants or loans to developing countries undertaken by the official sector (a) with the promotion of economic development and welfare as the main objective and (b) if a loan, having a grant element of at least 25 percent.

²⁴Office of Inspector General, *Review of Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs As of February 28, 2005* (Washington, D.C.: March 2005).

Figure 5: MCC's Compact Development Process



Source: GAO analysis and synthesis of MCC's compact development process.

Step 1: Proposal development. MCC expects eligible countries to propose projects and program implementation structures, building on existing national economic development strategies. For instance, the

Honduran government's proposal is based on its Poverty Reduction Strategy Paper (PRSP)²⁵ and a subsequent June 2004 implementation plan.²⁶ MCC also requires that eligible countries use a broad-based consultative process to develop their proposals.²⁷ MCC staff discuss the proposal with country officials during this phase of compact development. Although MCC does not intend to provide funding to countries for proposal development,²⁸ some countries have received grants from regional organizations for proposal development.²⁹

Step 2: Proposal submission and initial assessment. Eligible countries submit compact proposals or concept papers. MCC has not specified deadlines for proposal submission or publicly declared the limits or range of available funding for individual compacts. According to MCC officials, the absence of deadlines and funding parameters permits countries to take initiative in developing proposals. However, according to U.S.-based NGOs, the lack of deadlines has caused some uncertainty and confusion among eligible country officials. Honduran officials told us that knowing a range of potential funding would have enhanced their ability to develop a more focused proposal.

During this stage, MCC conducts a preliminary assessment of the proposal, drawing on its staff, contractors, and employees of other U.S. government agencies. This assessment examines the potential impact of the proposal's

²⁵The World Bank and IMF require countries to develop participatory poverty reduction strategies as a condition for receiving assistance. These strategies, which are outlined in countries' PRSPs, provide the basis for World Bank and IMF concessional lending and debt relief.

²⁶Republic of Honduras, *Attaining the Goals of the Poverty Reduction Strategy: Implementation Plan for 2004-2006, Consultative Group Meeting for Honduras, Tegucigalpa M.D.C., June 10-11, 2004* (Tegucigalpa: 2004).

²⁷The Millennium Challenge Act, Sec. 609(d), requires the United States, in entering into a compact, to ensure that eligible countries consider the perspectives of rural and urban poor, including women, and consult with private and voluntary organizations, the business community, and other donors.

²⁸The Millennium Challenge Act, Sec. 609(g), authorizes MCC to enter into contracts with, or make grants to, eligible countries to facilitate compact development and implementation.

²⁹For example, Mongolia has received assistance from The Asia Foundation to develop its proposal. In addition, Honduras and Nicaragua have received separate grants from the Central American Bank for Economic Integration (CABEI) and Inter-American Development Bank (IDB).

strategy for economic growth and poverty reduction, the consultative process used to develop the proposal, and the indicators for measuring progress toward the proposed goals. According to MCC, some eligible countries have moved quickly to develop their MCC programs. Others initially were unfamiliar with MCC's approach and some faced institutional constraints. MCC works with these countries to develop programs that it can support. In addition, MCC is exploring ways—such as providing grants—to facilitate compact development and implementation. Once MCC staff determine that they have collected sufficient preliminary information, they seek the approval of MCC's Investment Committee³⁰ to conduct a more detailed analysis, known as due diligence.

Step 3: Detailed proposal assessment and negotiation. MCC's due diligence review includes an analysis of the proposed program's objectives and its costs relative to potential economic benefits.³¹ Among other things, the review also examines the proposal's plans for program implementation, including monitoring and evaluation; for fiscal accountability; and for coordination with USAID and other donors. In addition, the review considers the country's commitment to MCC eligibility criteria and legal considerations pertaining to the program's implementation.³² During their review, MCC staff seek the approval of the Investment Committee to notify Congress that the corporation intends to initiate compact negotiations; following completion of the review, MCC staff request the committee's approval to enter compact negotiations. When the negotiations have been concluded, the Investment Committee decides whether to approve submission of the compact text to the MCC board.

³⁰The Investment Committee comprises MCC's CEO and vice presidents.

³¹MCC's cost-benefit analysis identifies, among other things, potential economic benefits and intended beneficiaries, as well as financial and nonfinancial (e.g., environmental impact) project costs. Previous GAO work on the Global Fund to Fight AIDS, TB and Malaria identified technical review of grant proposals as a challenging aspect of its operations. See U.S. Government Accountability Office, *Global Health: Global Fund to Fight AIDS, TB and Malaria Has Advanced in Key Areas, but Difficult Challenges Remain*, [GAO-03-601](#) (Washington, D.C.: May 7, 2003).

³²According to MCC documents, the legal considerations include the country's statutory requirements for compact approval and enforcement; Millennium Challenge Act section 605 prohibitions (i.e., military assistance and training; assistance relating to U.S. job loss or production displacement; assistance relating to environmental, health, or safety hazards; and use of funds for abortions and involuntary sterilizations); and exemption MCA assistance from taxation or reimbursement of such taxation.

Step 4: Board review and compact signing. The MCC board reviews the compact draft. Before the compact can be signed and funds obligated, the board must approve the draft and MCC must notify appropriate congressional committees of its intention to obligate funds.

MCC Has Identified Elements of Program Implementation and Fiscal Accountability Framework

MCC has identified several broadly defined elements of program implementation and fiscal accountability that it considers essential to ensuring achievement of compact goals and proper use of MCC funds. As signatories to the compact, MCC and the country government will be fundamental elements of this framework. However, MCC and eligible countries can adapt other elements (see fig. 6) by assigning roles and responsibilities to governmental and other entities according to the countries' compact objectives and institutional capacities.³³ Madagascar's compact incorporates these elements in addition to an advisory council composed of private sector and civil society representatives, as well as local and regional government officials. The compact also requires that MCA-Madagascar, the oversight entity, adopt additional plans and agreements before funds can be disbursed, including plans for fiscal accountability and procurement. In addition, the compact requires the adoption of a monitoring and evaluation plan; provides a description of the plan's required elements; and establishes performance indicators for each of Madagascar's three program objectives, which are linked to measures of the program's expected overall impact on economic growth and poverty reduction. MCC expects to disburse funds in tranches as it approves Madagascar's completed plans and agreements. According to the IG, MCC officials expect to make the initial disbursements within 2 months after signing the compact.³⁴

³³Many poor countries have weak, inefficient, and sometimes corrupt institutions that resist reform. See, for example, U.S. Government Accountability Office, *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges*, [GAO/NSIAD-00-161](#) (Washington, D.C.: June 2000). Also see C.I.C.E./Deloitte, *Senegal "MCA Jumpstart": Strengthening Planning and Management Systems to Support Accelerated Development in Senegal, "MCA Jumpstart" Summary Report, Phase 1* (Dakar, Senegal: USAID, January 2004) and C.I.C.E./Deloitte, *Senegal MCA Jumpstart Phase 2: Overcoming Absorptive Capacity Constraints* (Dakar, Senegal: USAID, November 2004).

³⁴Previous GAO work suggests that countries' effective use of development assistance may depend on their abilities to establish the necessary institutions for identifying projects and distributing funds. See, for example, our 2003 report on the Global Fund to Fight AIDS, TB and Malaria ([GAO-03-601](#)).

Figure 6: Adaptable Elements of MCC’s Framework for Program Implementation and Fiscal Accountability

Entity	Key roles/responsibilities	Governmental examples	Other examples
Country oversight entity	<ul style="list-style-type: none"> Oversees and manages program and projects Contracts with fiscal and procurement agents, project implementers, and auditors and reviewers Approves contract actions and requests for payment 	<ul style="list-style-type: none"> Prime minister's office Ministry 	<ul style="list-style-type: none"> Separate legal entity (e.g., council or committee) with government, civil society, and private sector representation Private company
Fiscal agent	<ul style="list-style-type: none"> Bank account signatory Documents transactions and authorizes redispbursement requests Provides accounting and financial reports 	<ul style="list-style-type: none"> Finance ministry 	<ul style="list-style-type: none"> Donor agency Accounting firm Commercial bank NGO
Procurement agent	<ul style="list-style-type: none"> Administers and/or certifies procurement process 	<ul style="list-style-type: none"> Ministries 	<ul style="list-style-type: none"> Donor unit Accounting firm Private company NGO
Bank account	<ul style="list-style-type: none"> Dedicated to MCC funds 	<ul style="list-style-type: none"> Central bank 	<ul style="list-style-type: none"> Commercial bank
Project implementer(s)	<ul style="list-style-type: none"> Implements projects specified in the country's compact Requests payments from the oversight entity Certifies delivery and receipt of goods and services 	<ul style="list-style-type: none"> Ministries 	<ul style="list-style-type: none"> Donor unit Private company NGO
Auditors and reviewers	<ul style="list-style-type: none"> Conducts financial audits, performance and compliance reviews, and data quality assessments 	<ul style="list-style-type: none"> Supreme Audit Institution Statistics institute 	<ul style="list-style-type: none"> Accounting firm Consulting firm Academic institution NGO

Source: GAO synthesis of MCC information.

MCC Is Taking Steps to Coordinate with Key Stakeholders

MCC has received advice and support from USAID, State, Treasury, and USTR and has signed agreements with five U.S. agencies for program implementation and technical assistance. In addition, MCC is consulting with other donors in Washington, D.C., and in the field to use existing donor expertise. MCC is also consulting with U.S.-based NGOs as part of its domestic outreach effort; however, some NGOs raised questions about the involvement of civil society groups. (See app. VII for more details of MCC’s coordination efforts.)

U.S. Agencies Are Contributing Resources and Technical Assistance

MCC initially coordinated primarily with U.S. agencies on its board and is expanding its coordination efforts to leverage the expertise of other agencies. USAID and the Department of State in Washington, D.C., and in compact-eligible countries, have facilitated meetings between MCC officials and donors and representatives of the private sector and NGOs in eligible countries. In addition, several of the six USAID missions contacted by GAO reported that their staff had provided country-specific information, had observed MCC-related meetings between civil society organizations and governments, or had informed other donors about MCC. MCC has also coordinated with the Department of the Treasury and USTR. For example, according to MCC officials, MCC has regularly briefed these agencies on specific elements of compact proposals and established an interagency working group to discuss compact-related legal issues.

Since October 2004, MCC has expanded its coordination through formal agreements with five U.S. agencies, including the Census Bureau, Army Corps of Engineers, and Department of Agriculture, that are not on the MCC board. MCC has obligated more than \$6 million for programmatic and technical assistance through these agreements, as shown in figure 7.

Figure 7: Agreements between MCC and U.S. Agencies

U.S. agency	Purpose	Funds obligated to agency	Agreement date and duration
U.S. Agency for International Development	Implement the Threshold Program, with MCC maintaining oversight and ultimate decision-making authority. (See app. IV for a detailed description of the program.)	USAID will charge MCC a flat administrative fee of 7 percent of funding that USAID obligates for the Threshold Program.	October 2004 Indeterminate duration ^a
	Provide grant or enter into an agreement with Government of Madagascar for the performance, completion and delivery of baseline statistical data that will be used to assess the impact of the Madagascar Compact.	\$1,300,000	March 2005 1-year duration
U.S. Department of the Treasury's Office of Technical Assistance	Assist in evaluating fiscal and financial aspects of MCC funded programs including ongoing oversight, monitoring and technical assistance in the areas of financial management as may be required for the execution of MCC Compacts.	\$1,200,000 ^b	February 2005 5-year duration
U.S. Army Corps of Engineers	Assist with evaluations of infrastructure projects proposed by MCC-eligible countries.	\$1,500,000 ^b	February 2005 5-year duration
	Evaluate roads project in Honduras.	\$192,753	November 2004 6-week duration
	Evaluate roads project in Cape Verde.	\$100,000	February 2005 5- to 6-week duration
U.S. Census Bureau	Assess monitoring and evaluation methodologies proposed by eligible countries and assist eligible countries in implementing the methodologies.	\$750,000 ^b	March 2005 3-year duration
U.S. Department of Agriculture's Foreign Agricultural Service	Assist in evaluating agricultural sector projects proposed by MCC-eligible countries.	\$1,000,000	March 2005 3-year duration

Source: GAO synthesis of MCC information as of April 2005.

^aFor fiscal year 2004 Threshold Program. All funds under this agreement must be obligated by September 30, 2005, unless MCC notifies USAID otherwise.

^bFunding is for a 1-year period.

MCC Is Consulting with Other Donors and Using Donor Expertise

MCC has received information and expertise from key multilateral and bilateral donors in the United States and eligible countries. For example, World Bank staff have briefed MCC regarding eligible countries, and officials from the Inter-American Development Bank said that they have provided MCC with infrastructure assessments in Honduras. According to MCC, most donor coordination is expected to occur in eligible countries rather than at the headquarters level. In some cases, MCC is directly coordinating its efforts with other donors through existing mechanisms, such as a G-17 donor group in Honduras.

In addition to soliciting donor input, MCC officials have encouraged donors not to displace assistance to countries that receive MCA funding.³⁵ Donors in Honduras told us that MCA funding to that country is unlikely to reduce their investment, because sectors included in the country's proposal have additional needs that would not be met by MCA.

MCC Has Met with NGOs

According to MCC officials, MCC is holding monthly meetings with a U.S.-based NGO working group³⁶ and hosted five public meetings in 2004 in Washington, D.C, as part of its domestic outreach efforts. The NGOs have shared expertise in monitoring and evaluation and have offered suggestions that contributed to the modification of 1 of MCC's 16 quantitative indicators. In addition, MCC has met with local NGOs during country visits.

Some U.S.-based NGOs have raised questions about the involvement of NGOs in this country and of civil society groups in compact-eligible countries. Environmental NGOs told us in January 2005 that MCC had not engaged with them since initial outreach meetings; however, MCC subsequently invited NGOs and other interested entities to submit proposals for a quantitative indicator of a country's natural resources management. Representatives of several NGOs commented that MCC lacks in-house expertise and staff to monitor and assess civil society participation in compact development. In addition, U.S.-based NGOs

³⁵Previous GAO work on the Global Fund to fight AIDS, TB and Malaria indicates that it can be difficult to monitor donor spending on specific programs and to ensure that new grants augment spending at the country level (see [GAO-03-601](#)).

³⁶The NGO Implementation Working Group on the Millennium Challenge Account includes InterAction, an alliance of more than 160 U.S.-based international development and humanitarian organizations.

expressed concern that their peers in MCA countries have not received complete information about the proposal development process.

MCC Has Made Progress in Developing Management Structures but Has Not Completed Corporatewide Plans, Strategies, and Time Frames

Since starting up operations, MCC has made progress in developing key administrative infrastructures that support its program implementation. MCC has also made progress in establishing corporatewide structures for accountability, governance, internal control, and human capital management, including establishing an audit and review capability through its IG, adopting bylaws, providing ethics training to employees, and expanding its permanent full-time staff. However, MCC has not yet completed plans, strategies, and time frames needed to establish these essential management structures on a corporatewide basis. (See fig. 8 for a detailed summary of MCC's progress.)

Figure 8: MCC's Progress on Key Management Structures

Key management structures	Actions completed	Actions under way or planned
<p>Administrative infrastructure <i>Basic infrastructure needed to support program operations.</i></p>	<ul style="list-style-type: none"> Acquired temporary offices Outsourced administrative aspects of accounting and human resource functions to Department of the Interior's National Business Center Hired initial staff Developed and implemented computer network 	<ul style="list-style-type: none"> Move to new location in Washington, D.C. (May 2005) Develop records management policy
<p>Accountability <i>Effectively demonstrating to both internal and external parties (e.g., Congress, public) that resources are managed properly; programs are achieving intended goals and outcomes; and programs are provided efficiently and effectively.</i></p>	<ul style="list-style-type: none"> Issued statements of mission and goals in various documents; began strategic planning Completed initial audits of MCC's financial statements and related internal control, ethics program, and efforts to achieve intended organizational structure, under the direction of MCC's statutorily-designated IG Issued consolidated report to satisfy annual reporting requirements of Millennium Challenge Act and Government Corporation Control Act 	<ul style="list-style-type: none"> Complete strategic planning process; issue strategic plan Issue annual performance plan (required under the Government Performance and Results Act)^b Conduct several follow-on IG audits (e.g., financial statements, ethics, internal control, achieving organizational structure) Complete development of methodology for monitoring and evaluating compacts, including metrics that will be incorporated into compacts and used to evaluate a country's progress
<p>Corporate governance <i>Collective policies and mechanisms used by the Board to effectively oversee management efforts to establish and maintain a sustainable and accountable organization.</i></p>	<p>MCC Board</p> <ul style="list-style-type: none"> Adopted bylaws Approved selection criteria and methodology for eligible counties Selected initial round of countries eligible to enter into compacts Approved MCC officers Board established a compensation committee in March 2005, and a charter for the committee is being drafted MCC is drafting a policy related to the board's corporate governance 	<ul style="list-style-type: none"> Develop an approved board policy on corporate governance
<p>Internal control <i>Integral component of organization management that provides reasonable assurance that key objectives—efficiency and effectiveness of operations, reliability of financial reporting, and compliance with applicable laws and regulations—are being achieved.</i></p>	<ul style="list-style-type: none"> Adopted accounting principles Documented the compact development process (including role and composition of Investment Committee) Performed due diligence reviews of proposed compact programs Established Ethics Program and conducted related training Established Investment Committee to oversee compact development process Established procedures detailing actions that require legal review and clearance MCC established an internal controls strategy group to formalize the assessment of the corporation's internal control environment, identify risks, assign priorities and responsibility, and establish time frames Implemented various policies (e.g., government vehicle use, security, use of information technology resources) Using federal travel regulation and federal acquisition regulation Developed policies for work hours/overtime and leave Established interagency legal working group that meets with board agency attorneys to discuss pending international legal issues 	<ul style="list-style-type: none"> Complete development of additional management tools (e.g., compact development pipeline) to assist staff, management, and MCC board in monitoring the compact development process Provide Contracting Officer Technical Representative (COTR) training Develop financial management policies and procedures Supplement federal travel and acquisition regulations with policies applicable to MCC Work with IG to develop compact audit provision
<p>Human capital management <i>Leadership, strategic human capital planning, developing and retaining talent, and a results-oriented culture are the cornerstones of strategic human capital management.</i></p>	<ul style="list-style-type: none"> Established organizational structure Obtained Schedule A hiring authority from the Office of Personnel Management (OPM)^a Planned initial staffing projections Contracted with international recruiting firm to expand hiring efforts Contracted with human capital consultant 	<ul style="list-style-type: none"> Develop strategic human capital plans Continue recruitment Issue competitive hiring plans and procedures by March 31, 2006 (required by OPM) Complete compensation study by summer 2005 Adopt employee Performance Management Program

Source: GAO; items under "Actions completed" and "Actions under way or planned" represent GAO's synthesis of MCC information.

^aSchedule A refers to positions specifically excepted from federal competitive service requirements.

^bAccording to MCC officials, MCC and OMB have agreed that MCC may submit a modified report to satisfy the Government Performance and Results Act requirement of a performance plan and report by March 31, 2005. MCC expects to submit the report by the end of fiscal year 2005.

Administrative Infrastructure

During its first 15 months, MCC management focused its efforts on establishing essential administrative infrastructures—the basic systems and resources needed to set up and support its operations—which also contribute to developing a culture of accountability and control. In February 2004, MCC acquired temporary offices in Arlington, Virginia, and began working to acquire a permanent location. In addition, consistent with its goal of a lean corporate structure with a limited number of full-time employees, MCC outsourced administrative aspects of its accounting, information technology, travel, and human resource functions. Further, MCC implemented various other administrative policies and procedures to provide operating guidance to staff and enhance MCC’s internal control. MCC management continues to develop other corporate policies and procedures, including policies that will supplement federal travel and acquisition regulations.

Accountability

Accountability requires that a government organization effectively demonstrate, internally and externally, that its resources are managed properly and used in compliance with laws and regulations and that its programs are achieving their intended goals and outcomes and are being provided efficiently and effectively. Important for organizational accountability are effective strategic and performance planning and reporting processes that establish, measure, and report an organization’s progress in fulfilling its mission and meeting its goals. External oversight and audit processes provide another key element of accountability.

During its initial 15 months, MCC developed and communicated to the public its mission, the basic tenets of its corporate vision, and key program-related decisions by the MCC board. MCC began its strategic planning process when key staff met in January 2005 to begin setting strategic objectives and it expects to issue the completed plan in the coming months. In addition, MCC arranged with its IG for the audit of its initial year financial statements (completed by an independent public accounting firm) and for two program-related IG reviews. However, to date, MCC has not completed a strategic plan or established specific implementation time frames. In addition, MCC has not yet established annual performance plans, which would facilitate its monitoring of progress toward strategic and annual performance goals and outcomes

and its reporting on such progress internally and externally. According to MCC officials, MCC intends to complete its comprehensive strategic and performance plans by the end of fiscal year 2005.

Corporate Governance

Corporate governance can be viewed as the formation and execution of collective policies and oversight mechanisms to establish and maintain a sustainable and accountable organization while achieving its mission and demonstrating stewardship over its resources. Generally, an organization's board of directors has a key role in corporate governance through its oversight of executive management, corporate strategies, risk management and audit and assurance processes, and communications with corporate stakeholders.

During its initial 15 months, the MCC board adopted bylaws regarding board composition and powers, meetings, voting, fiscal oversight, and the duties and responsibilities of corporate officers and oversaw management's efforts to design and implement the compact program. According to MCC, during a recent meeting of the board to discuss corporate governance, the Chief Executive Officer solicited feedback from the board regarding defining and improving the governance process. MCC's board established a compensation committee in March 2005, and a charter for the committee is being drafted. In addition, MCC is preparing, for board consideration, a policy on the board's corporate governance. As drafted, the policy identifies the board's statutory and other responsibilities, elements of board governance, rules and procedures for board decision-making, and guidelines for MCC's communications with the board. With regard to MCC board membership, seven of the nine board members have been appointed and installed. Through board agency staff, MCC staff have regularly informed board members—four of whom are heads of other agencies or departments—about pending MCC matters.

The board has not completed a comprehensive strategy or plan for carrying out its responsibility—specifically, it has not defined the board's and management's respective roles in formulating and executing of corporate strategies, developing risk management and audit and assurance processes, and communicating and coordinating with corporate stakeholders. Moreover, although the bylaws permit the board to establish an audit committee—to support the board in accounting and financial reporting matters; determine the adequacy of MCC's administrative and financial controls; and direct the corporation's audit function, which is provided by the IG and its external auditor—the board has not yet done

so. Finally, two of the MCC board's four other positions have not yet been filled.

Internal Control

Internal control provides reasonable assurance that key management objectives—efficiency and effectiveness of operations, reliability of financial reporting, and compliance with applicable laws and regulations—are being achieved. Generally, a corporatewide internal control strategy is designed to

- create and maintain an environment that sets a positive and supportive attitude toward internal control and conscientious management;
- assess, on an ongoing basis, the risks facing the corporation and its programs from both external and internal sources;
- implement efficient control activities and procedures intended to effectively manage and mitigate areas of significant risk;
- monitor and test control activities and procedures on an ongoing basis; and
- assess the operating effectiveness of internal control and report and address any weaknesses.

During its first 15 months, MCC took several actions that contributed to establishing effective internal control. Although it did not conduct its own assessment of internal control, MCC management relied on the results of the IG reviews and external financial audit to support its conclusion that key internal controls were valid and reliable. Further, MCC implemented processes for identifying eligible countries and internal controls through its due diligence reviews of proposed compacts, establishment of the Investment Committee to assist MCC staff in negotiating and reviewing compact proposals, and the board's involvement in approving negotiated compacts. In addition, MCC instituted an Ethics Program, covering employees as well as outside board members, to provide initial ethics orientation training for new hires and regularly scheduled briefings for employees on standards of conduct and statutory rules. In April 2005, MCC officials informed us that they had recently established an internal controls strategy group to identify internal control activities to be implemented over the next year, reflecting their awareness of the need to focus MCC's efforts on the highest-risk areas.

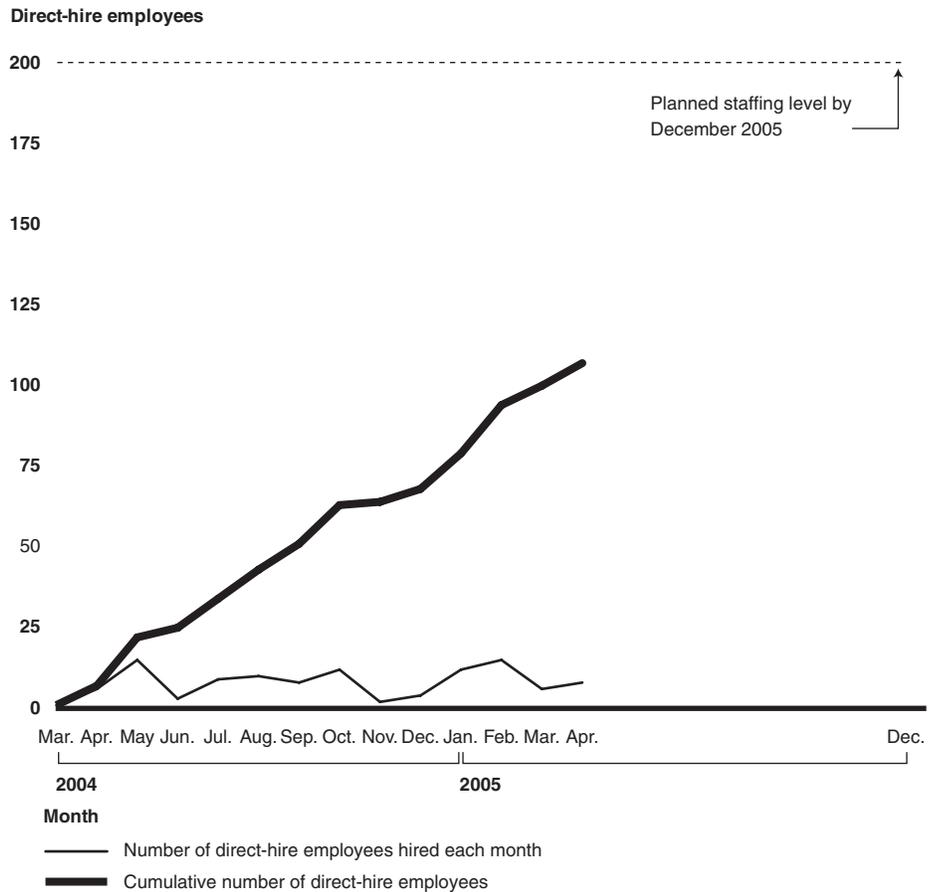
However, MCC has not completed a comprehensive strategy and related time frames for ensuring the proper design and incorporation of internal control into MCC's corporatewide program and administrative operations. For example, MCC intends to rely on contractors for a number of operational and administrative services; however, this strategy will require special consideration in its design and implementation of specific internal controls.

Human Capital Management

Cornerstones of human capital management include leadership; strategic human capital planning; acquiring, developing, and retaining talent; and building a results-oriented culture. In its initial year, MCC human capital efforts focused primarily on establishing an organizational structure and recruiting employees necessary to support program design and implementation and corporate administrative operations (see app. VIII for a diagram of MCC's organizational structure). MCC set short- and longer-term hiring targets, including assigning about 20 employees—depending on the number and types of compacts that have been signed—to work in MCA compact-eligible countries; it also identified needed positions and future staffing levels through December 2005 based on its initial operations. With the help of an international recruiting firm, MCC expanded its permanent full-time staff from 7 staff employees in April 2004 to 107 employees in April 2005; it intends to employ no more than 200 permanent full-time employees by December 2005 (see fig. 9).³⁸ In addition, MCC hired 15 individuals on detail, under personal services contracts, or as temporary hires, as well as a number of consultants. Finally, in January 2005, MCC hired a consultant to design a compensation program to provide employees with pay and performance incentives and competitive benefits, including performance awards and bonuses, retention incentives, and student loan repayments. MCC officials told us that they intend the program to be comparable with those of federal financial agencies, international financial institutions, and multilateral and private sector organizations.

³⁷Fifteen of these positions are administratively determined; Congress authorized 30 such positions for MCC in the Millennium Challenge Act.

Figure 9: Actual and Planned Staffing Levels as of April 1, 2005



Source: GAO analysis of unaudited MCC data as of April 2005.

MCC has not completed an institutional infrastructure that includes (1) a thorough and systematic assessment of the staffing requirements and critical skills needed to carry out its mission; (2) a human capital planning process that integrates MCC's human capital policies and strategies with its program goals and mission; and (3) a performance management system that links employees' pay and incentive programs to individual knowledge, skills, performance, and contributions. MCC officials acknowledged the need to refine and systematize MCC's workforce planning to ensure that the corporation has the human capital capability needed for a broad range of programs in a number of developing nations.

Conclusions

In its first 15 months, MCC took important actions to design and implement the compact program—making eligibility determinations, defining its compact development process, and coordinating and establishing working agreements with key stakeholders. MCC also acted to establish important elements of a corporatwide management structure needed to support its mission and operations, including some key internal controls. However, MCC has not yet fully developed plans that define the comprehensive actions needed to establish key components of an effective management structure.

We believe that, to continue to grow into a viable and sustainable entity, MCC needs to approve plans with related time frames that identify the actions required to build a corporatwide foundation for accountability, internal control, and human capital management and begin implementing these plans. In addition, MCC's board needs to define its responsibilities for corporate governance and oversight of MCC and develop plans or strategies for carrying them out. As MCC moves into its second year of operations, it recognizes the need to develop comprehensive plans and strategies in each of these areas. Implementation of such plans and strategies should enable MCC's management and board to measure progress in achieving corporate goals and objectives and demonstrate its accountability and control to Congress and the public. As part of our ongoing work for your committee, we will continue to monitor MCC's efforts in these areas.

Recommendations for Executive Action

We recommend that the Chief Executive Officer of the Millennium Challenge Corporation complete the development and implementation of overall plans and related time frames for actions needed to establish

1. Corporatwide accountability, including
 - implementing a strategic plan,
 - establishing annual performance plans and goals,
 - using performance measures to monitor progress in meeting both strategic and annual performance goals, and
 - reporting internally and externally on its progress in meeting its strategic and annual performance goals.
2. Effective internal control over MCC's program and administrative operations, including establishing

-
- a positive and supportive internal control environment;
 - a process for ongoing risk assessment;
 - control activities and procedures for reducing risk, such as measures to mitigate risk associated with contracted operational and administrative services;
 - ongoing monitoring and periodic testing of control activities; and
 - a process for assessing and reporting on the effectiveness of internal controls and addressing any weaknesses identified.
3. An effective human capital infrastructure, including
- a thorough and systematic assessment of the staffing requirements and critical skills needed to carry out MCC's mission;
 - a plan to acquire, develop, and retain talent that is aligned with the corporation's strategic goals; and
 - a performance management system linking compensation to employee contributions toward the achievement of MCC's mission and goals.

We recommend that the Secretary of State, in her capacity as Chair of the MCC Board of Directors, ensure that the board considers and defines the scope of its responsibilities with respect to corporate governance and oversight of MCC and develop an overall plan or strategy, with related time frames, for carrying out these responsibilities. In doing so, the board should consider, in addition to its statutory responsibilities, other corporate governance and oversight responsibilities commonly associated with sound and effective corporate governance practices, including oversight of

- executive management,
- the formulation and execution of corporate strategies,
- risk management and audit and assurance processes, and
- communication and coordination with corporate stakeholders.

Agency Comments and Our Evaluation

MCC provided technical comments on a draft of this statement and agreed to take our recommendations under consideration; we addressed MCC's comments in the text as appropriate. We also provided the Departments of State and Treasury, the U.S. Agency for International Development, and the Office of the U.S. Trade Representative an opportunity to review a draft of this statement for technical accuracy. State and USAID suggested no changes, and Treasury and USTR provided a few technical comments, which we incorporated as appropriate.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I will be happy to answer any questions you may have.

Contacts and Acknowledgments

For questions regarding this testimony, please call David Gootnick at (202) 512-4128 or Phillip Herr at (202) 512-8509.

Other key contributors to this statement were Todd M. Anderson, Beverly Bendekgey, David Dornisch, Etana Finkler, Ernie Jackson, Debra Johnson, Joy Labez, Reid Lowe, David Merrill, John Reilly, Michael Rohrback, Mona Sehgal, and R.G. Steinman.

Appendix I: Scope and Methodology

We reviewed MCC's activities in its first 15 months of operations, specifically its (1) process for determining country eligibility for fiscal years 2004 and 2005, (2) progress in developing compacts, (3) coordination with key stakeholders, and (4) establishment of management structures and accountability mechanisms.

To examine MCC's country selection process, we analyzed candidate countries' scores for the 16 quantitative indicators for fiscal years 2004 and 2005, as well as the selection criteria for the fiscal year 2004 Threshold Program. We used these data to determine the characteristics of countries that met and did not meet the indicator criteria and to assess the extent to which MCC relied on country scores for eligibility determination. We also reviewed the source data for the indicator scores posted on MCC's Web site to identify issues related to public access and to determine whether we could reproduce the country scores from the source data. Our review of the source data methodology, as well as the documents of other experts, allowed us to identify some limitations of the indicator criteria used in the country selection process. For these and other data we used in our analyses, we examined, as appropriate, the reliability of the data through interviews with MCC officials responsible for the data, document reviews, and reviews of data collection and methodology made available by the authors. We determined the data to be reliable for the purposes of this study.

To describe MCC's process for developing compacts, including plans for monitoring and evaluation, we reviewed MCC's draft or finalized documents outlining compact proposal guidance, compact proposal assessment, and fiscal accountability elements. We reviewed eligible countries' compact proposals and concept papers to identify proposed projects, funding, and institutional frameworks, among other things. To summarize the projects that countries have proposed and that MCC is currently assessing, we developed categories and conducted an analysis of countries' proposal documents and MCC's internal summaries. We also reviewed Madagascar's draft compact to identify projects, funding, and framework for program implementation and fiscal accountability. We met with MCC officials to obtain updates on the compact development process. In addition, we interviewed representatives of nongovernmental organizations (NGOs) in Washington, D.C., and Honduras, as well as country officials in Honduras, to obtain their perspectives on MCC's compact development process.

To assess MCC's coordination with key stakeholders, we reviewed interagency agreements to identify the types of formal assistance that

MCC is seeking from U.S. agencies and the funding that MCC has set aside for this purpose. We also reviewed MCC documents to identify the organizations, including other donors, with which MCC has consulted. In addition, we interviewed MCC officials regarding their coordination with various stakeholders. We met with officials from the U.S. agencies on the MCC board (Departments of State and Treasury, USAID, and USTR) to assess the types of assistance that these agencies have provided to MCC. We also contacted six USAID missions in compact-eligible countries to obtain information on MCC coordination with U.S. agencies in the field. To assess MCC's coordination with NGOs and other donors, we met with several NGOs, including InterAction, the World Wildlife Fund, and the Women's Edge Coalition in Washington, D.C., and local NGOs in Honduras; we also met with officials from the Inter-American Development Bank in Washington, D.C., and Honduras, as well as officials from the World Bank, Central American Bank for Economic Integration, and several bilateral donors in Honduras. Finally, we attended several MCC public outreach meetings in Washington, D.C.

To analyze MCC's progress in establishing management structures and accountability mechanisms, we interviewed MCC senior management and reviewed available documents to identify the management and accountability plans that MCC had developed or was planning to develop. We reviewed audit reports by the USAID Office of the Inspector General to avoid duplication of efforts. We used relevant GAO reports and widely used standards and best practices, as applicable, to determine criteria for assessing MCC's progress on management issues as well as to suggest best practices to MCC in relevant areas. Although our analysis included gaining an understanding of MCC's actions related to establishing internal control, we did not evaluate the design and operating effectiveness of internal control at MCC.

In January 2005, we conducted fieldwork in Honduras, one of four countries with which MCC had entered into negotiations at that time, to assess MCC's procedures for conducting compact proposal due diligence and its coordination with U.S. agencies, local NGOs, Honduran government officials, and other donors. In conducting our field work, we met with U.S. mission officials, Honduran government officials, donor representatives, and local NGOs. We also visited some existing USAID projects in the agricultural sector that were similar to projects that Honduras proposed.

We provided a draft of this statement to MCC, and we have incorporated technical comments where appropriate. We also provided a draft of this

statement to the Departments of State and Treasury, USAID, and USTR; State and USAID suggested no changes, and Treasury and USTR provided technical comments, which we addressed as appropriate. We conducted our work between April 2004 and April 2005, in accordance with generally accepted government auditing standards.

Appendix II: Candidate and Eligible Countries for MCA and Threshold Programs, Fiscal Years 2004-2005

Candidate countries	MCC compact-eligible countries		Threshold Program countries		Candidate countries <i>(continued)</i>	MCC compact-eligible countries		Threshold Program countries	
	2004	2005	2004	2005		2004	2005	2004	2005
Afghanistan					Lesotho	Lesotho	Lesotho		
*Albania			*Albania		Madagascar	Madagascar	Madagascar		
Angola					Malawi				Malawi
Armenia	Armenia	Armenia			Mali	Mali	Mali		
Azerbaijan					Mauritania				
Bangladesh					Moldova				
Benin	Benin	Benin			Mongolia	Mongolia	Mongolia		
Bhutan					Morocco		Morocco		
Bolivia	Bolivia	Bolivia			Mozambique	Mozambique	Mozambique		
*Bosnia and Herzegovina					Nepal				
Burkina Faso				Burkina Faso	Nicaragua	Nicaragua	Nicaragua		
Cameroon					Niger				
*Cape Verde	*Cape Verde				Nigeria				
Chad					Pakistan				
China					Papua New Guinea				
Comoros					Paraguay				Paraguay
Congo Democratic Republic					Philippines				Philippines
Congo, Rep.					Rwanda				
Djibouti					São Tomé and Príncipe			São Tomé and Príncipe	São Tomé and Príncipe
East Timor			East Timor	East Timor	Senegal	Senegal	Senegal		
Egypt, Arab Rep. of					Sierra Leone				
Eritrea					Solomon Islands				
Ethiopia					Sri Lanka	Sri Lanka	Sri Lanka		
Gambia					Swaziland				
Georgia	Georgia	Georgia			Tajikistan				
Ghana	Ghana	Ghana			Tanzania			Tanzania	Tanzania
Guinea					Togo				
Guinea-Bissau**					*Tonga				
Guyana				Guyana	Turkmenistan				
Haiti					Uganda			Uganda	Uganda
Honduras	Honduras	Honduras			Ukraine				
India					Vanuatu	Vanuatu	Vanuatu		
Indonesia					Vietnam				
Kenya			Kenya	Kenya	Yemen Republic			Yemen Republic	Yemen Republic
Kiribati					Zambia				Zambia
Kyrgyz Republic									
Lao PDR									

* Candidate for FY 2004 only.

** Prohibited under Foreign Assistance Act in FY 2004 but not in FY 2005.

█ Candidate for FY 2005 only.

Source: GAO analysis and synthesis of MCC data.

Note: The countries listed do not include the 12 and 14 countries that were not candidates because of legal prohibitions in fiscal years 2004 and 2005, respectively.

Appendix III: Indicators Used in the Selection Process

Table 1 lists each of the indicators used in the MCA compact and threshold country selection process, along with its source and a brief description of the indicator and the methodology on which it is based.

Table 1: Quantitative Indicators Used to Determine MCA Country Eligibility

RULING JUSTLY		
Indicator/Source	Description	Methodology
Political rights Freedom House, Freedom in the World 2003	Measures the ability of citizens to participate freely in the political process. This includes the right to vote, elect representatives who have real power, and compete for public office.	A survey providing an annual evaluation of the state of global freedom. A panel of experts uses a broad range of sources of information, including foreign and domestic news reports, nongovernmental organization publications, think tank and academic analyses, individual professional contacts, and visits to the region. The panel rates countries on the prevalence of free and fair elections of officials with real power; the ability of citizens to form political parties that may compete fairly in elections; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies, and economic oligarchies; and the political rights of minority groups. Countries receive numerical ratings from 1 to 7, with 1 being the most free.
Civil liberties Freedom House, Freedom in the World 2003	Measures citizen's freedom to develop opinions, institutions, and personal autonomy without interference from the state.	
Voice and accountability Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003	Measures the ability of institutions to protect civil liberties, the extent to which citizens of a country are able to participate in the selection of governments, and the independence of the media.	An index of surveys based on several hundred individual variables measuring perceptions of governance, drawn from 25 separate data sources constructed by 18 different organizations. The governance indicators are measured in units ranging from –2.5 to 2.5, with higher values corresponding to better governance outcomes.
Government effectiveness Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003	Measures the ability of the government to formulate and implement sound policies, including quality of public service provision, quality of bureaucracy, competency of civil servants, independence of civil service from political pressures, credibility of the government's commitment to policies.	

<p>Rule of law</p> <p>Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi , The World Bank, 2003</p>	<p>Measures the extent to which the public has confidence in, and abides by, rules of society. Includes perception of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.</p>	
<p>Control of corruption</p> <p>Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi , The World Bank, 2003</p>	<p>Rates countries on the frequency of “additional payments to get things done,” the effects of corruption on the business environment, “grand corruption” in the political arena, and the tendency of elites to engage in “state capture.”</p>	

INVESTING IN PEOPLE

Indicator/Source	Description	Methodology
<p>Primary (girls’) education completion rate</p> <p>World Bank (EdStats and Education for All, World Development Indicators) and UNESCO Institute for Statistics, various years</p>	<p>The number of students (girls) completing primary education, divided by the population in the relevant age cohort.</p>	<p>EdStats compiles data from a variety of sources. The primary sources are the UNESCO Institute for Statistics (UIS), the Organization for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the World Bank and its client countries.</p>
<p>Primary education spending (% OF GDP)</p> <p>National Governments and World Bank (Education For All), various years</p>	<p>Total expenditures on primary education by government at all levels, divided by GDP.</p>	<p>Data from national sources was gathered directly from the governments of both the candidate countries and the legally prohibited countries in March and April 2004 with the assistance of U.S. embassies.</p>
<p>Public health spending (% OF GDP)</p> <p>National Governments, supplemented by World Bank (World Development Indicators), various years</p>	<p>Total expenditures on health by government at all levels, divided by GDP.</p>	<p>Same methodology as Primary education spending (% of GDP).</p>
<p>Diphtheria and measles immunization rate</p> <p>World Health Organization and UNICEF estimates of National Immunization Coverage, 2002</p>	<p>The average of DPT3 and measles immunization rates for the most recent year available.</p>	<p>Data officially reported to WHO and UNICEF by Member States in addition to data reported in the published and grey literature. WHO and UNICEF also consult with local experts - primarily national EPI managers and WHO regional office staff - for additional information regarding the performance of specific local immunization services. The true level of immunization is based on estimates of national immunization for various vaccines.</p>

ECONOMIC FREEDOM

Indicator/Source	Description	Methodology
<p>Country credit rating <i>Institutional Investor</i>, March 2004</p>	<p>A semi-annual survey of bankers' and fund managers' perceptions of a country's risk of default.</p>	<p><i>Institutional Investor</i> reports regularly and provides credit ratings, based on the perceived risk of government default, every 6 months for 145 countries, including 85 MCA countries. Countries are ranked on a scale from 1 to 100 based on information provided by economists and sovereign risk analysts from banks and money management and securities firms.</p>
<p>Fiscal policy IMF World Economic Outlook, 2003 or more recent data, if available</p>	<p>Overall budget deficit (after receipt of grants but not concessional loans; includes interest on debt) divided by GDP, averaged over a 3-year period.</p>	<p>The IMF provided the MCC with the budget deficit data, which is otherwise not publicly available. We do not know what methodology the IMF used to obtain this data for all countries. However, WEO short-term fiscal policy assumptions for advanced economies are based on officially announced budgets adjusted for differences between the national authorities and the IMF staff regarding macroeconomic assumptions and projected fiscal outcomes.</p>
<p>Trade policy Heritage Foundation/Wall Street Journal 2004 Index of Economic Freedom</p>	<p>A country's openness to international trade based on average tariff rates and nontariff barriers to trade, on a scale of 1 to 5, with 1 being the most open.</p>	<p>This is a subjective indicator. The countries are rated from 1 to 5, based primarily on tariff and quota rates, where available.</p>
<p>Regulatory quality Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003</p>	<p>Measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, as well as perception of the burdens imposed by excessive regulation in areas such as foreign trade and business development.</p>	<p>Same methodology as voice and accountability, above.</p>
<p>Days to start a business May 2004, World Bank <i>Doing Business</i></p>	<p>The number of days required for companies to complete all procedures necessary to legally start a business.</p>	<p><i>Doing Business</i> compiles a comprehensive list of entry regulations by recording all the procedures that are officially required for an entrepreneur to obtain all necessary permits, and to notify and file with all requisite authorities, in order to legally operate a business. The data are from January 2003.</p>

One-year consumer price inflation

IMF *International Financial Statistics* (2002, 2003), supplemented by national government data, and IMF's World Economic Outlook, various years

The most recent 12-month change in consumer prices as reported in the IMF's *International Financial Statistics* or in another public forum by the relevant national monetary authorities.

Consumer price indexes (CPI) are used most frequently as an indicator of inflation. The CPI reflect changes in the cost of acquiring a fixed basket of goods and services by the average consumer. Weights are derived from household expenditure surveys, which may be conducted infrequently.

Since announcing the 16 quantitative indicators that it used to determine country eligibility for fiscal year 2004, MCC made two changes for fiscal year 2005 and is exploring further changes for fiscal year 2006. To better capture the gender concerns specified in the Millennium Challenge Act, MCC substituted "girls' primary education completion rate" for "primary education completion rate." It also lowered the ceiling for the inflation rate indicator from 20 to 15 percent. In addition, to satisfy the act's stipulation that MCC use objective and quantifiable indicators to evaluate a country's commitment to economic policies that promote sustainable natural resource management, MCC held a public session on February 28, 2005, to launch the process of identifying such an indicator. MCC expects to complete the process by May 2005.

Appendix IV: Threshold Program Selection Process

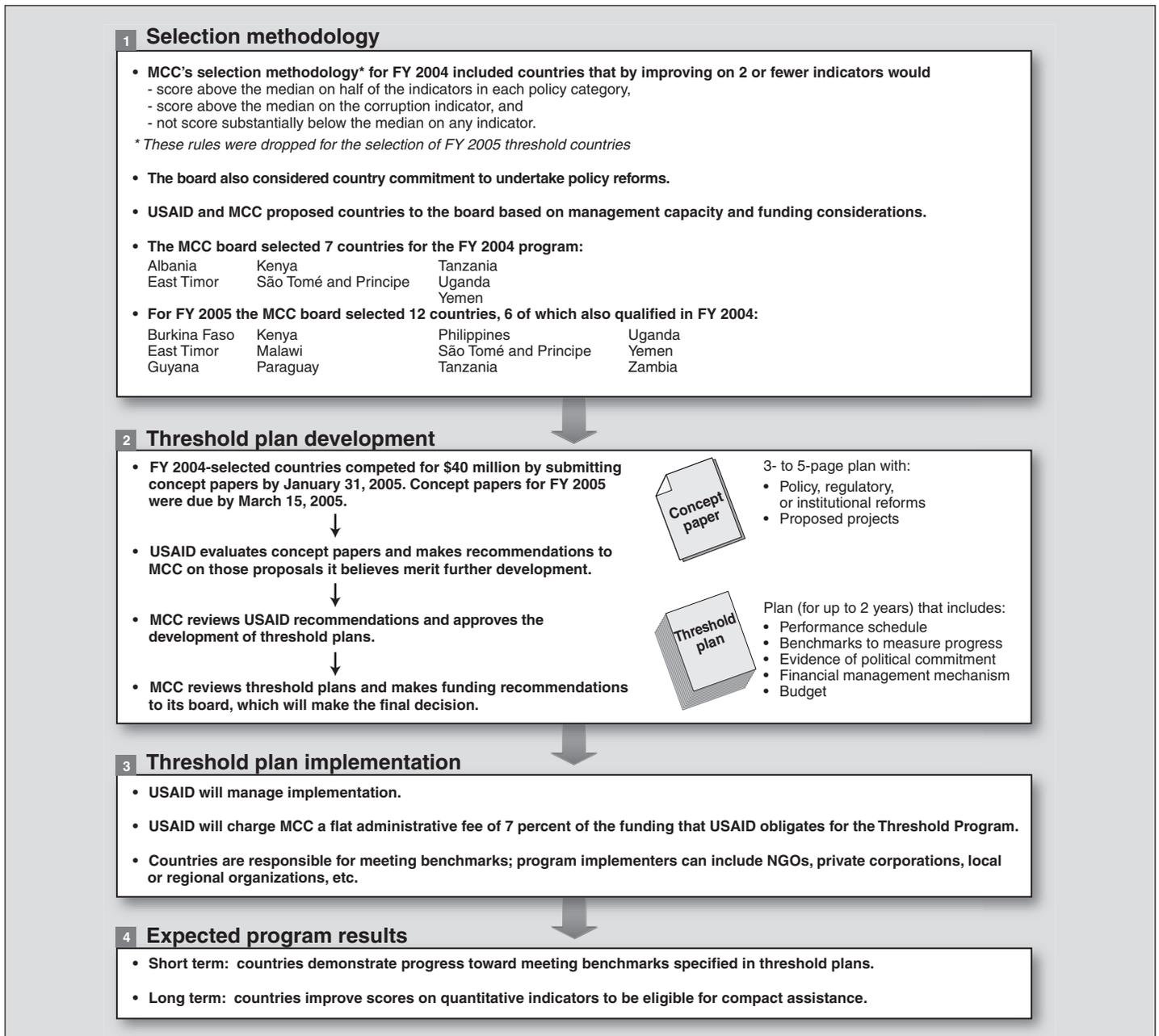
The MCC board used objective criteria (a rules-based methodology) and exercised discretion to select the threshold countries (see fig. 10). For fiscal year 2004, the MCC board relied on objective criteria in selecting as Threshold Program candidates countries that needed to improve in 2 or fewer of the 16 quantitative indicators used to determine MCA eligibility. (That is, by improving in two or fewer indicators, the country would score above the median on half of the indicators in each policy category, would score above the median on the corruption indicator, and would not score substantially below the median on any indicator.) MCC identified 15 countries that met its stated criteria and selected 7 countries to apply for Threshold Program assistance. Our analysis suggests that one of these seven countries did not meet MCC's stated Threshold Program criteria.¹ The MCC board also exercised discretion in assessing whether countries that passed this screen also demonstrated a commitment to undertake policy reforms to improve in deficient indicators.

For fiscal year 2005, the MCC did not employ a rules-based methodology for selecting Threshold Program candidates. Instead, the board selected Threshold Program and MCA compact-eligible countries simultaneously. The board selected 12 countries to apply for Threshold Program assistance, including reconfirming the selection of 6 countries² that also had qualified for the fiscal year 2004 Threshold Program.

¹Yemen would have had to improve on at least three indicators to meet the fiscal year 2004 Threshold Program criteria.

²Albania was not a candidate for fiscal year 2005 due to per capita income above the IDA ceiling.

Figure 10: MCC's Threshold Program

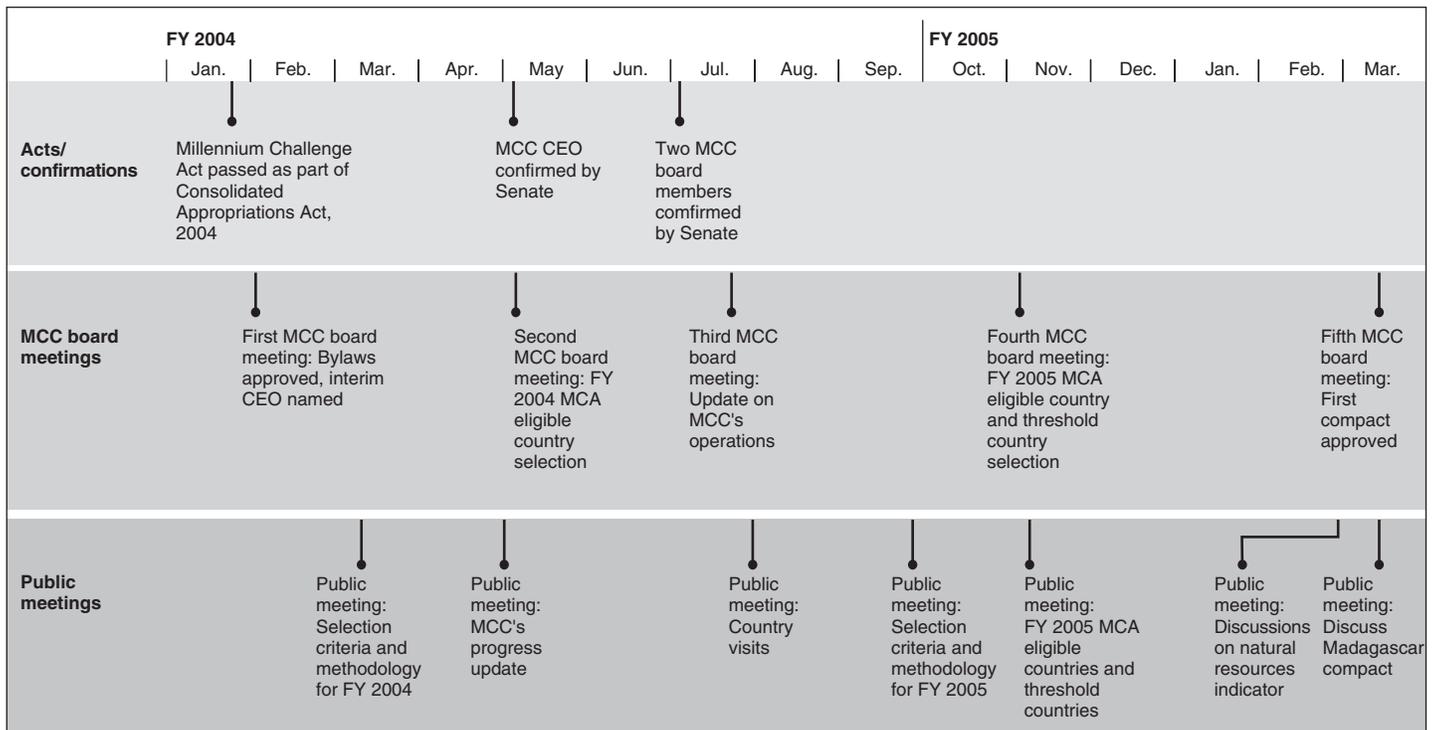


Source: GAO synthesis of MCC's Threshold Program process.

Appendix V: Timeline of Key Events

Figure 11 illustrates key events and defining actions relating to MCC since the passage of the Millennium Challenge Act in January 2004.

Figure 11: Timeline of Key MCC-related Events and Actions, Fiscal Years 2004-2005

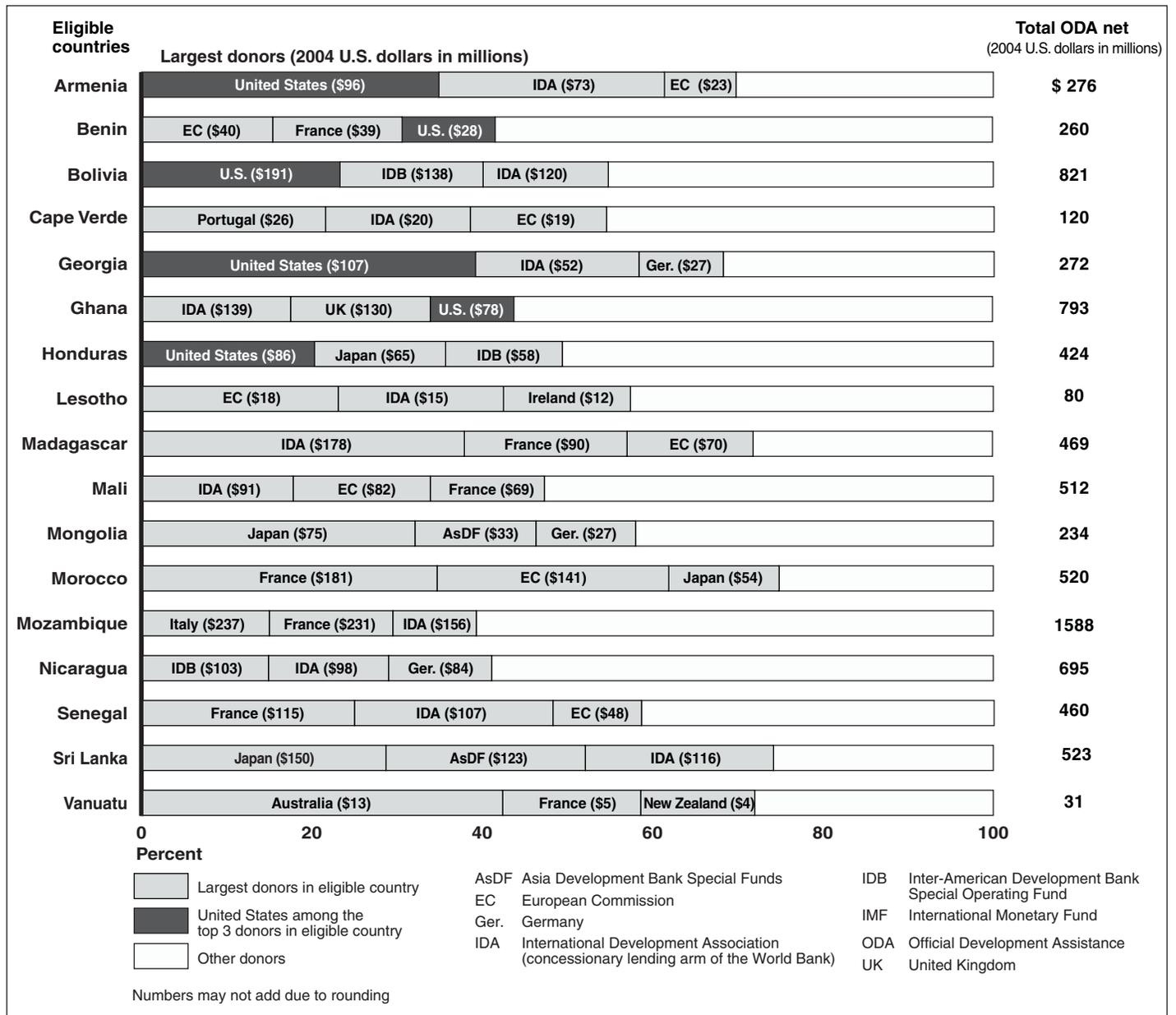


Source: GAO synthesis of MCA information through March 2005.

Appendix VI: Donors in MCA Compact-eligible Countries

MCC plans to be among the top donors in MCA compact-eligible countries. Figure 12 shows the total official development assistance net (average for 2002 and 2003) provided by the top three donors as well as the amount of total official development assistance net (average for 2002 and 2003) provided by all donors in each of the MCA compact-eligible countries. As the figure indicates, based on the average for the years 2002-2003, the United States was the top donor in Armenia, Bolivia, Georgia, and Honduras and was among the top five donors in nine additional countries.

Figure 12: Top Donors in MCA Compact-eligible Countries, Total Annual ODA Net, Average for 2002 – 2003



Source: GAO, based on Organization for Economic Cooperation and Development (OECD) data.

Appendix VII: MCC Coordination with Key Stakeholders

MCC is coordinating its program and funding activities with various stakeholders to keep them informed and to utilize their expertise or resources at headquarters and in the field (see fig. 13). In addition, several U.S. agencies have taken steps to coordinate their activities with MCC.

Figure 13: MCC Coordination with Key Stakeholders

	Coordination mechanisms	Examples of coordination
U.S. agencies	<ul style="list-style-type: none"> • USAID established an MCC coordination unit with three staff • State has assigned an MCA coordinator • Treasury and USTR officials are providing advice or reviewing information as needed • MCC has signed agreements with <ul style="list-style-type: none"> - USAID to design and implement Threshold Program - U.S. Army Corps of Engineers (USACE) to evaluate proposed infrastructure projects - Treasury's Office of Technical Assistance to assess and monitor fiscal accountability - U.S. Census Bureau to evaluate proposed monitoring and evaluation methodologies. - USDA to evaluate proposed agricultural sector projects. 	<ul style="list-style-type: none"> • USAID and State facilitated MCC country visits • USAID provided country-specific information to MCC. • USAID formulated its 2003^a regional strategy for Central America around MCC's three policy categories. • State provided supplemental information for country selection process. • Treasury has facilitated coordination with multilateral donors. • USTR has facilitated meetings with World Trade Organization ambassadors of eligible countries. • USDA has reviewed agricultural projects. • USACE is helping review infrastructure projects.
Donors	<ul style="list-style-type: none"> • MCC conducts direct outreach to and consultations with donors in headquarters and eligible countries • Existing donor coordination mechanism in eligible countries 	<ul style="list-style-type: none"> • Eligible countries are using World Bank- and IMF-supported Poverty Reduction Strategy Papers to develop compact proposals. • IMF provided budget data for MCC's fiscal policy indicator. • Inter-American Development Bank (IDB) has provided studies and assessments. • World Bank and IDB officials have briefed MCC. • MCC has sought program-specific input from donors in eligible countries.
NGOs	<ul style="list-style-type: none"> • Public meetings • NGO-specific meetings 	<ul style="list-style-type: none"> • U.S. NGOs have helped MCC identify country-based NGOs • NGOs have shared monitoring and evaluation expertise • NGOs provided input to make an <i>Investing in People</i> indicator gender sensitive

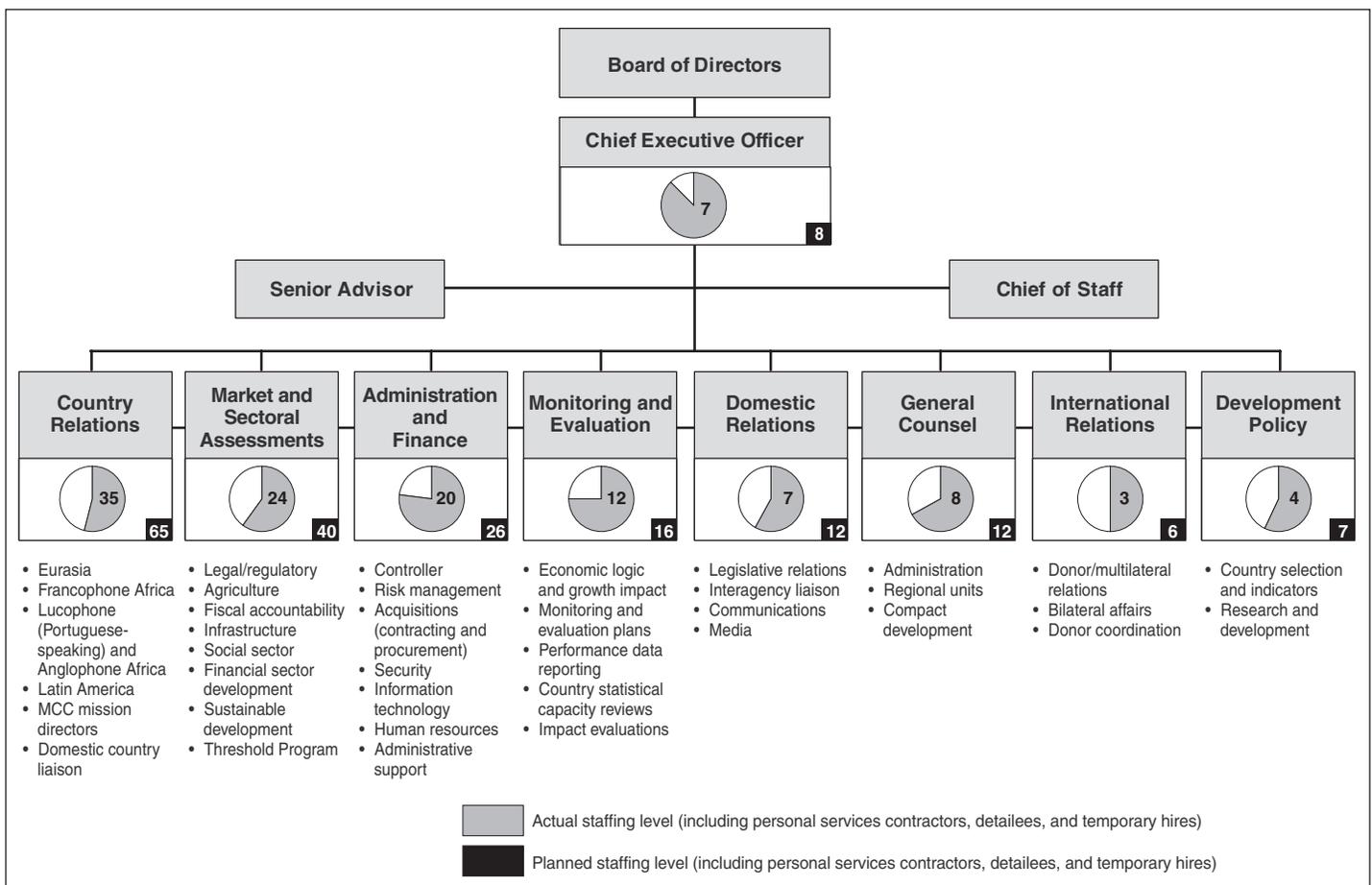
Source: GAO synthesis of information provided by MCC.

^aAlthough MCC was formally established in February 2004, an interagency team that included representatives from the National Security Council, State, USAID, Treasury, and the Office of Management and Budget began designing and implementing the MCA initiative in the spring of 2002.

Appendix VIII: MCC Organizational Structure

Within each of the eight functional areas shown in figure 14, the actual staffing level as of April 2005 appears in the pie chart in each box and the planned staffing level by December 2005 appears in the right corner of each box.

Figure 14: MCC Organizational Structure As of April 1, 2005



Source: GAO synthesis of MCC information.

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