



Millennium Challenge Corporation

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Summary

The Millennium Challenge Corporation (MCC) provides economic assistance through a competitive selection process to developing nations that are pursuing political and economic reforms in three areas: ruling justly, investing in people, and fostering economic freedom.

Established in 2004, the MCC differs in several respects from past and current U.S. aid practices:

- the competitive process that rewards countries for past actions measured by 17 objective performance indicators;
- the pledge to segregate the funds from U.S. strategic foreign policy objectives that often strongly influence where U.S. aid is spent;
- its mandate to seek poverty reduction through economic growth, not encumbered with multiple sector objectives;
- the requirement to solicit program proposals developed solely by qualifying countries with broad-based civil society involvement;
- the responsibility of recipient countries to implement their own MCC-funded programs, known as compacts;
- a compact duration limited to five years, with funding committed up front;
- the expectation that compact projects will have measurable impact;
- an emphasis on public transparency in every aspect of agency operations.

In February 2011, the Obama Administration issued its FY2012 budget, requesting \$1.125 billion for the MCC, a 2% increase from the enacted FY2010 appropriation and a 25% increase over the final FY2011 appropriation. Following a series of continuing appropriations, in April 2011, Congress approved H.R. 1473 (P.L. 112-10), providing \$900 million for the MCC in FY2011. After applying a .2% across-the-board non-defense rescission, the MCC receives \$898 million in FY2011, a 19% decrease from the FY2010-enacted level.

Congress authorized the MCC in P.L. 108-199 (January 23, 2004). Since that time, the MCC's Board of Directors has approved 23 grant agreements, known as compacts: with Madagascar (2005), Honduras (2005), Cape Verde (2005), Nicaragua (2005), Georgia (2005), Benin (2006), Vanuatu (2006), Armenia (2006), Ghana (2006), Mali (2006), El Salvador (2006), Mozambique (2007), Lesotho (2007), Morocco (2007), Mongolia (2007), Tanzania (2007), Burkina Faso (2008), Namibia (2008), Senegal (2009), Moldova (2009), Philippines (2010), Jordan (2010), and Malawi (2011).

MCC issues include the level of funding to support MCC programs, the impact of budget reductions on MCC programs, the rate of program implementation, the results of MCC compacts, and procurement and corruption concerns.

This report will be updated as events unfold.

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Most Recent Developments

On April 15, 2011, the Full-Year Continuing Appropriations Act of 2011 (P.L. 112-10, H.R. 1473) was signed, providing \$900 million for the MCC in FY2011. After applying a .2% across-the-board non-defense rescission, the MCC receives \$898 million in FY2011, a 19% decrease from the FY2010-enacted level.

In February 2011, the Obama Administration issued its FY2012 budget, requesting \$1.125 billion for the MCC, a 2% increase from the enacted FY2010 appropriation and a 25% increase over the final FY2011 appropriation.

On January 5, 2011, the MCC Board approved a \$350.7 million compact for Malawi (signed on April 7, 2011) focusing on electric power development. The Board also selected Ghana and Georgia as eligible to develop new, second compacts.

Introduction

In a speech on March 14, 2002, President Bush outlined a proposal for a new program that would represent a fundamental change in the way the United States invests and delivers economic assistance. The resulting Millennium Challenge Corporation (MCC) is based on the premise that economic development succeeds best where it is linked to free market economic and democratic principles and policies, and where governments are committed to implementing reform measures in order to achieve such goals. The MCC concept differs in several fundamental respects from past and current U.S. aid practices:

- the competitive process that rewards countries for past actions measured by 17 objective performance indicators;
- the pledge to segregate the funds from U.S. strategic foreign policy objectives that often strongly influence where U.S. aid is spent;
- its mandate to seek poverty reduction through economic growth, not encumbered with multiple sector objectives;
- the requirement to solicit program proposals developed solely by qualifying countries with broad-based civil society involvement;
- the responsibility of recipient countries to implement their own MCC-funded programs, known as compacts;
- a compact duration limited to five years, with funding committed up front;
- the expectation that compact projects will have measurable impact;
- an emphasis on public transparency in every aspect of agency operations.

The original proposal also differed from previous aid efforts in the size of its commitment to reach an annual level of \$5 billion within a few years, an aim never even approximately met.

Congress approved the new initiative in January 2004 in the Millennium Challenge Act of 2003 (Division D of P.L. 108-199).¹ To manage the initiative, Congress authorized the creation of a Millennium Challenge Corporation (MCC), an independent government entity separate from the Departments of State and the Treasury and from the U.S. Agency for International Development (USAID).² The MCC headquarters staff level is currently about 258, with a handful of additional employees in each compact country.³ On December 8, 2009, Daniel Yohannes was sworn in as the new Chief Executive Officer (CEO) of the MCC. A Board of Directors oversees the MCC and makes the country selections. It is chaired by the Secretary of State and composed of the Secretary of the Treasury, the USAID Administrator, the U.S. Trade Representative, the Corporation's CEO, and four individuals from the private sector appointed by the President drawn from lists submitted by Congressional leaders.⁴

Since its inception, Congress has closely followed MCC implementation. The 112th Congress will likely consider MCC funding issues and conduct oversight hearings on operations of the Corporation.

MCC Policy and Programs

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

¹ When first proposed and in its early years, the initiative was known as the Millennium Challenge Account. Today, both the program and the funding account in the foreign operations budget are more commonly known by the name of the managing entity, the MCC. For a more in-depth discussion of the original MCC proposal and issues debated by Congress in 2003, see CRS Report RL31687, *The Millennium Challenge Account: Congressional Consideration of a New Foreign Aid Initiative*, by Larry Nowels.

² The decision to house the initiative in a new organization was one of the most debated issues during early congressional deliberations. The Bush Administration argued that because the initiative represents a new concept in aid delivery, it should have a "fresh" organizational structure, unencumbered by bureaucratic authorities and regulations that would interfere in effective management. Critics, however, contended that if the initiative was placed outside the formal U.S. government foreign aid structure, it would lead to further fragmentation of policy development and consistency. Some believed that USAID, the principal U.S. aid agency, should manage the program, while others said that it should reside in the State Department. At least, some argued, the USAID Administrator should be a member of the MCC Board, which had not been proposed in the initial Administration request. The MCC's status remained unchanged under Secretary of State Rice's realignment of foreign aid authorities, announced on January 19, 2006. While gaining policy and budget authority over nearly all USAID and State Department foreign aid programs, the new Director of Foreign Assistance in the State Department played a more limited role in other agency activities, developing an overall U.S. government development strategy and only providing "guidance" to foreign aid programs delivered through other agencies like the MCC.

³ MCC, *MCC Financial Report, Fiscal Year 2010*, p. 15.

⁴ Current private sector board members are Mark Green, former congressman and ambassador to Tanzania, serving his first term, and Alan Patricof, co-founder of a venture capital corporation, serving his second term. First terms run three years and second terms run two years. Two board seats are currently vacant.

Selection of Candidate Countries

The selection of initial candidate countries is fairly straightforward and based on the authorizing statute. Countries must fall into specific economic categories determined by their per capita income status (as defined and ranked by the World Bank). MCC participation is limited to all low- and lower-middle-income countries (the former with per capita incomes below \$1,905 and the latter between that figure and \$3,945 in FY2011), a total of 84 in FY2011. Countries in the low-income group compete with other countries in the low-income group; countries in the lower-middle-income group compete with each other.

As the relative income status of countries changes from year to year, their MCC eligibility is affected, often negatively. For FY2011, two countries—Azerbaijan and Albania, the latter with a threshold program—have moved from lower-middle-income to upper-middle income status and are, therefore, now ineligible for further MCC assistance. Namibia signed a compact in 2008 and, therefore, continues its program regardless of the upper-middle income status gained in FY2010.

Countries that move from low-income to lower-middle-income status may be affected negatively by having to compete against countries at a higher level of development. In addition, under the MCC legislative authority, only a quarter of total MCC assistance in any year is available for lower-middle-income country compacts, severely limiting the possibility that such countries will be selected or funded. For FY2010, this would have affected the chances of countries like Indonesia and the Philippines, which would have been in a better position to obtain a compact had they remained in the low-income group. In September 2009, the MCC Board announced that, for countries that move from low to lower-middle-income status, it will consider their performance relative to both their old income group and the newer one for a period of three years. Further, the FY2010 Consolidated appropriations (P.L. 111- 117, H.R. 3288, Division F) allows transitioning countries already selected in FY2009 to maintain their candidacy for eligibility and, if reselected, draw on the same source of funds as when they were first selected. A possible compact for Indonesia, reselected in FY2010, will therefore be funded as though in the low-income group.⁵

In addition to the income ceiling, countries may be candidates only if they are not statutorily prohibited from receiving U.S. economic assistance. For FY2011, 11 countries were excluded for this reason. Most had been barred in prior years as well.⁶ One, Madagascar, excluded in FY2010 because of an undemocratic change in government, was one of the first compact countries and, in losing its eligibility, had its program terminated early.

In August 2010, the MCC transmitted to Congress its annual notification of candidate countries, listing 55 low-income countries and 29 lower-middle-income countries (see **Table 4** and **Table 5**).

⁵ The Philippines moved to the lower-middle income level in FY2010, signed a compact as a low-income country in FY2010, and has now returned to low-income status in FY2011.

⁶ Various types of aid restrictions applied to these countries. For several—Sudan, Cote d'Ivoire, and Madagascar—U.S. aid was blocked because an elected head of government had been deposed by a military coup. For Uzbekistan, legislation banned assistance to the central government. Aid restrictions imposed on nations not cooperating in counter-narcotics efforts (Burma), that are on the terrorist list (Sudan, Syria, North Korea), or in arrears on debt owed the United States (Syria, Sudan) also applied. Notwithstanding these and other restrictions, each country remained eligible for humanitarian assistance from the United States.

Eligible Country Selection Criteria and Methodology

As noted earlier, the MCC provides assistance to developing nations through a competitive selection process, judged by country performance in three areas:

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

Country selection is based largely, but not exclusively, on a nation's record measured by 17 performance indicators related to these three categories, or "baskets." Countries that score above the median on half of the indicators in each of the three baskets qualify. Emphasizing the importance of fighting corruption, the indicator for corruption is a "pass/fail" test: should a country fall below the median on the corruption indicator, it will be disqualified from consideration unless other, more recent trends suggest otherwise. (See **Table 6** below for a complete list of the 17 performance indicators.)

The choice of criteria on which to base the eligibility of countries for MCC programs is one of the most important elements in MCC operations. They are a key statement of MCC development priorities as they ultimately determine which countries will receive U.S. assistance. Perhaps of equal significance, the current indicators themselves have become prominent objectives of some developing countries in what former CEO Danilovich called the "MCC effect."⁷ Countries seeking eligibility are said to be moving on their own to enact reforms and take measures that would enable them to meet MCC criteria.

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

As noted above, the main criteria is that a country has demonstrated a commitment to good governance, economic freedom, and investments in its people (especially in health and education). In addition to criteria originally proposed by the Bush Administration, lawmakers included four other matters on which to evaluate a country's performance. These relate to the degree to which a country recognizes the rights of people with disabilities; respects worker rights; supports a sustainable management of natural resources; and makes social investments, especially in women and girls. For each of these, the MCC has sought to use supplemental data and qualitative information to inform its decisions on compact eligibility. The latter two factors have led to the development of new indicators.

With regard to the requirement added by Congress regarding social investments in women and girls, at first the MCC reported it would draw on girls' primary enrollment rates to supplement the four social investment performance indicators. But in FY2005, an indicator measuring girls'

⁷ MCC Public Outreach Meeting, February 15, 2007.

primary education completion rates replaced a broader measure used in FY2004 that did not disaggregate primary education graduation by gender.

Beginning with the FY2005 selection process, the MCC lowered the inflation rate threshold from 20% to 15%, making it somewhat more difficult to pass this test (only 6 of the 63 candidate countries failed this test for FY2004). For FY2006, the Corporation added a new indicator—the Cost of Starting a Business—that replaced a Country Credit Rating. The Corporation believed that not only did the new indicator have a strong correlation with economic growth, but that it was a measurement that might encourage governments to take action in order to improve their scores. Since the initial use of the indicator Days to Start a Business, MCC candidate countries had introduced many business start-up reforms, the results of which were reflected in a lowered median for this category. MCC officials hoped that adding an indicator for the Cost of Starting a Business would stimulate additional policy improvements. They believed that the Country Credit Rating indicator was not as well linked to policy reforms and that it had a greater income bias than other MCC indicators.

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

In the explanatory statement accompanying the FY2009 Omnibus appropriations (P.L. 111-8), Congress urged the Board of Directors to consider establishment of an indicator that would take into consideration the votes and positions of countries in international institutions with regard to human rights issues. The MCC explored this option and noted in its September 2009 criteria report that as indicators measuring commitment to human rights within a country already exist and a country's voting record could be influenced by political goals, the suggested indicator was not appropriate.

Selection of Eligible Countries

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

A review of the history of MCC selections suggests that the Board is guided by, but not entirely bound to, the outcome of the performance indicator review process; board members can apply discretion in their selection. Performance trends, missing or old data, and recent policy actions might come into play during selection deliberations.

Just because a country passes the requisite number of qualifying indicators does not mean that it will be selected for compact eligibility. This can be due to a variety of reasons, not least of which is the limited funding available to support compacts. The Board is not required to give a reason for its selections and only occasionally offers one. Most often it appears that a country passes half or more of the qualifying indicators in each basket, but is not selected because it scores very poorly—perhaps in the lowest 25th percentile—in one or more of the remaining indicators. For example, in FY2005, the Philippines passed 13 of the then-16 indicators, but was not made eligible, because it scored “substantially below” the median on tests for health expenditures and fiscal policy, and that more recent trends indicated the fiscal policy situation was deteriorating further.⁸ In FY2006, Bhutan, China, and Vietnam passed enough hurdles but were not chosen based on very low scores on political rights and civil liberties; Uganda passed 12 of the 16 indicators and did not fall significantly below the median on the other four, but was not selected for unexplained reasons.

At times, countries have been deemed compact eligible without meeting a sufficient number of qualifying factors or with weak scores in some qualifying areas. In most such cases, the Board takes into consideration recent policy changes or positive trend lines. For example, in FY2004, the program’s first year, several countries were selected despite having failed the so-called “pass-fail” corruption indicator. Mozambique, which failed on corruption and each of the four “investing in people” indicators, was chosen based on supplemental data that was more current than information available from the primary data sources. This evidence, the Board felt, demonstrated Mozambique’s commitment to fighting corruption and improving its performance on health and education. In FY2004, Cape Verde scored poorly on the Trade Policy indicator, but the Board took into account the country’s progress towards joining the World Trade Organization and implementing a value added tax to reduce reliance on import tariffs. Lesotho did not score well on the measurement for Days to Start a Business. The MCC Board, however, took note of Lesotho’s creation of a central office to facilitate new business formation and saw positive performance on other factors related to business start-ups. In FY2011, Georgia was invited to submit a proposal for a second compact despite failure in the investing in people basket; supplemental information attributing an insufficient score in immunization rates to a temporary shortage of one vaccine helped the Board toward a positive decision.

Even prior to its selection in FY2007, the possible choice of Jordan had come in for severe criticism from some quarters. Freedom House, the organization whose annual Index of Freedom is drawn upon for two of the “Ruling Justly” indicators, had urged the MCC Board to bypass countries that had low scores on political rights and civil liberties. It argued that countries like Jordan that fall below 4 out of a possible 7 on its index should be automatically disqualified. Jordan, however, did well on three of the other indicators in this category. Several development analysts further argued that Jordan should not be selected, because it is one of the largest recipients of U.S. aid, has access to private sector capital, and is not a democracy.⁹ In selecting Jordan, the MCC Board appears not to have been swayed by these arguments.

⁸ Comments by Paul Applegarth, then MCC CEO, at a State Department Foreign Press Center Briefing, November 9, 2004.

⁹ Freedom House, “Millennium Challenge Corporation Should Hold Countries to Higher Standards of Democratic Governance,” November 2, 2006, <http://www.freedomhouse.org>; Sheila Herrling, Steve Radelet, and Sarah Rose, “Will Politics Encroach in the MCA FY2007 Selection Round? The Cases of Jordan and Indonesia,” Center for Global Development, October 30, 2006, <http://www.cgdev.org>.

The Board has, at times, selected a country and then, in future years, and prior to approval of a compact, de-selected it if its qualifying scores worsened or other factors interceded. Although the Gambia was selected in FY2006, its eligibility for MCC assistance was suspended by the MCC Board in June 2006 because of “a disturbing pattern of deteriorating conditions” in half of the 16 qualifying factors. Among the problems cited in this case were human rights abuses, restrictions on civil liberties and press freedom, and worsened anti-corruption efforts.¹⁰ For the 2008 selection process, the MCC Board eliminated Sri Lanka because of the resurgent civil strife that would make a compact problematic. In the FY2009 selection round, the Board decided not to reselect several countries that had been eligible in previous years—Bolivia, Timor-Leste, and Ukraine. In FY2008 and FY2009, both Ukraine and Timor-Leste failed the corruption indicator. Timor-Leste, in addition, failed the “investing in people” basket in those years. Bolivia, however, had passed its indicator test in every year. A hold put on MCC consideration of its compact proposal in FY2008 and its exclusion from eligibility in FY2009 appeared likely due to the political tensions existing between it and the United States rather than its performance in development-related matters.

A number of countries have remained eligible despite failing performances in years following their selection. For example, Indonesia, selected in FY2009, and now in the process of preparing a compact proposal, fails the corruption indicator and investing in people basket in FY2011. Cape Verde, selected in FY2010 for a second compact, also fails the investing in people basket in FY2011. Both countries remain compact-eligible. Indonesia, because Congress has allowed it to be judged and funded as a lower income country, in which case it passes the selection requirements. Cape Verde remains eligible, because revised data for FY2011 on expenditures for primary education was received from UNESCO after the score was tabulated indicating it would have passed that indicator and the investing in people basket.

Countries that are already implementing compacts generally appear unaffected by a decline in performance indicators. Nine of the 19 countries implementing compacts as of January 2011 would not qualify in FY2011.¹¹ Georgia and Vanuatu have failed three years in a row; Armenia, El Salvador, Mali, and Mozambique have failed four years in a row. Morocco has failed for five years straight.¹²

In not strictly following the rule of the performance indicators, the MCC argues that the indicators themselves are imperfect measures of a country’s policies and performance. The indicators often suffer from lag time, reflecting when the raw data was derived as much as a year or more previously. A country’s position *vis-a-vis* its peers may also fluctuate considerably from year to year without reflecting any significant change in the country’s policies. Countries following reasonable policies may fall behind the performance criteria when other countries are improving faster—thereby raising the bar. A shift in position from the low income to lower-middle income group can similarly alter a country’s scores as it competes with countries more likely to achieve better indicators than ones in the lower income group. They may also fail when new criteria are introduced which countries have not had an opportunity to address and when institutions measuring performance refine or revise their indicators.

¹⁰ MCC Press Release, “The Gambia Suspended From Participation in MCC Compact Program,” June 15, 2006.

¹¹ These are Armenia, Burkina Faso, El Salvador, Georgia, Mali, Mongolia, Morocco, Mozambique, and Vanuatu.

¹² For further discussion, see Casey Dunning, Owen McCarthy, and Sarah Jane Staats, Center for Global Development, *Round Eight of the MCA*, December 3, 2010.

Country Selection—FY2011

In its FY2011 selection round, the MCC Board reselected countries currently in the process of preparing their compact proposals—Indonesia, Zambia, and Cape Verde—and selected Ghana and Georgia as eligible to develop second compacts.

Table 1. Compact-Eligible Countries: FY2011

Low-Income Countries	Lower-Middle-Income Countries
Ghana Zambia Indonesia ((a lower-middle income country, but for eligibility and funding, treated as a low-income country until FY2012)	Cape Verde Georgia

MCC Compacts

MCC compacts are grant agreements, none more than five-years in length (as required by the MCC authorization), proposed and implemented by countries selected by the MCC Board. Details of each compact and significant developments in their implementation are provided below (under Compact Descriptions).

As of April 2011, 36% of MCC compact funding was in the transport sector, mostly roads; 20% was targeted on agriculture; 9% on health, education, and community services; 9% on water supply and sanitation; 8% on energy; 4% on governance, and 2% on financial services. Counting all 23 compact countries to date, 58% of compact funding has gone to sub-Saharan African countries, 12% to North Africa and the Middle East, 10% to the former Soviet Union, 10% to Latin America, and 10% to Asia and the Pacific.

Since its inception, the MCC has designed guidelines and procedures for project development and implementation that are followed by all MCC compact countries. These are described below.

Compact Development

Once declared as eligible, countries may prepare and negotiate program proposals with the MCC. Only those compact proposals that demonstrate a strong relationship between the proposal and economic growth and poverty reduction will receive funding.

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

Countries designate an entity, usually composed of government and non-government personnel, to coordinate the formulation of the proposal and act as a point of contact with the MCC. In many cases, a high level of political commitment to the program—country leadership identifying themselves closely with the success of the compact—helps propel compact development forward and continues into implementation.

The MCC did not set hard deadlines for compact submissions in order to allow countries adequate time to conduct a national dialogue over the contents of the program proposal. Underscoring the MCC concept of “country-ownership” and the requirement of broad public participation in the development of MCC programs embodied in MCC authorization language, the compact development entity typically launches nationwide discussions regarding the scope and purpose of the MCC grant, with meetings held at the regional and national level that include representation of civil society and the business community. In Namibia, the National Planning Commission charged with developing the compact, identified 500 issues as a result of public discussions held throughout the country on the question “What will unlock economic development in your region?”, narrowing them down to 77, and then just to several.¹³ Burkina Faso’s consultations reportedly included 3,100 people in all 13 regions.¹⁴

Public consultation combined with analysis of constraints to growth help focus a country on the range of sectors and possible activities that might go into a compact proposal. Concept papers are developed around many of these ideas. During each step in the development process, the MCC provides feedback to keep the country within MCC parameters.

The eventual result of these public deliberations and concept papers are compact proposals. These proposal often exceed MCC’s budget capacity, forcing a process of further prioritization and elimination. Tanzania reportedly suggested a package worth \$2 billion; with the elimination of irrigation and education options, they were able to bring it down to \$700 million. Namibia’s first proposal, at \$415 million, was whittled down to \$305 million by eliminating irrigated agriculture and roads projects.

Proposals are developed by a country with the guidance of and in consultation with the MCC. To assist in compact development, the MCC may, under section 609(g) of its authorizing statute, provide so-called pre-compact development grants to assist the country’s preparatory activities. Among other things, these grants may be used for design studies, baseline surveys, technical and feasibility studies, environmental and social assessments, ongoing consultations, fees for fiscal and/or procurement agents, and the like. For example, in June 2009, the MCC provided Jordan with a pre-compact development grant of \$13.34 million, not counted as part of the final compact. It was used for feasibility studies and other assessments for water and wastewater projects.

One feature of compact proposals is the requirement that sustainability issues be addressed. In the case of road construction, this might mean provisions committing the government to seek to establish transport road funds, a fuel levy or some other tax to pay for road maintenance in future. For example, as a condition of its compact, Honduras increased its annual road maintenance budget from \$37 million to \$64 million.¹⁵

¹³ Tanzania and Namibia examples in this section are based on author interviews.

¹⁴ Rebecca Schutte, *Burkina Faso Field Report*, Center for Global Development, July 2009.

¹⁵ MCC, *Policy Reforms Matter*, September 9, 2010.

Once a proposal is submitted, the MCC conducts an initial assessment, then, on the basis of that assessment, launches a due diligence review that closely examines all aspects of the proposal, including costs and impacts to see if they are worthy of MCC support. Included in the review is an economic analysis assessing anticipated economic rates of return for the proposed projects and estimating the impact on poverty reduction. At the same time, MCC staff work with the country to refine program elements. Finally, the MCC negotiates a final compact agreement prior to its approval by the MCC Board. The compact is signed but does not enter into force until supplemental agreements on disbursements and procurement are reached.¹⁶

When the compact enters into force the clock begins to tick on compact implementation and the total amount of funds proposed for the compact are formally obligated (held by the U.S. Treasury until disbursed). Because of the difficulties encountered in trying to undertake a complex set of projects within a set five-year time span, MCC has increasingly sought to front load many planning activities prior to compact signing or entry-into-force, including feasibility studies and project design, which in the case of infrastructure can be a lengthy process. Usually, the first year of operations is consumed by contract design and solicitation for services. In the case of Burkina Faso, however, one analyst noted that the passage of a full year between signing and entry-into-force combined with early action on staff and planning, allowed an estimated 60% of procurement to be initiated before entry-into-force.¹⁷

Compact Implementation

The MCC signed its first compact, with Madagascar, on April 18, 2005, an event that was followed by four other signings in 2005—with Honduras, Cape Verde, Nicaragua, and Georgia. In 2006, six more agreements were signed: Benin, Vanuatu, Armenia, Ghana, Mali and El Salvador. In 2007, four compacts were signed—with Mozambique, Lesotho, Morocco, Mongolia. In 2008, three, with Tanzania, Burkina Faso, and Namibia were signed. In 2009, one compact, with Senegal was signed. Compacts with Moldova, the Philippines, and Jordan were signed in 2010. So far in 2011, one compact with Malawi was signed.

Typically, by the time of signing, the entity that was established as point of contact during program development segues into the compact management and oversight body, the “accountable entity” usually known as the MCA. Its board is usually composed of government and non-government officials, including representatives of civil society. The government representatives are usually ministers most closely associated with compact project sectors. The MCA itself may take a variety of forms. In Tanzania, it is a government parastatal established by presidential decree under the Ministry of Finance. In Namibia, it is a separate unit within the ministry-level government National Planning Commission.

MCA staff will include fiscal and procurement agents, in many cases duties contracted out and in some cases, where the capacity is available, undertaken in-house. In the case of Namibia, for example, procurement started as a contracted function, and, when capacity improved, the contractor was replaced by an MCA-staffed procurement office. The MCA is also responsible for ensuring that accountability requirements concerning audits, monitoring, and evaluation take place. Environmental, gender, and other social requirements embedded in the compact agreement are its responsibility as well. Held to a strict five-year timetable and limited budget, the MCA

¹⁶ Details on each of the negotiated compacts can be found at the MCC website: <http://www.mcc.gov>.

¹⁷ Rebecca Schutte, Center for Global Development, *Burkina Faso Field Report*, July 2009, p. 1.

faces a daunting challenge for most developing countries. For many countries, the process of getting the MCA set up, staffed, and operating was very time consuming and difficult, in some cases causing delays in implementation.

As, perhaps, the most important aspect of compact implementation, MCC procurement processes are a good example of how the MCC is building government capacity at the same time that it provides development project assistance and maintains accountability oversight for the use of U.S. funds. MCC-supported procurements are fixed-price contracts, putting the burden on the contractor to get the work done to meet the agreed price. The MCC has a set of standards and guidelines for all its project contracting. The MCC requires that procurements are preceded by a price reasonableness analysis to ensure that bids are realistic. An independent evaluation panel is selected for each discrete procurement, with all members requiring MCC approval to ensure that appropriate technical expertise is represented. The panel's report is also vetted by the MCC.

Reportedly, several countries have adopted this methodology for their procurements. Cape Verde is applying it to all public procurements. Honduras says it will maintain the program management unit to deal with projects funded by other donors and will apply MCC guidelines for procurement.¹⁸

The MCC itself has only a very small staff located in-country, composed chiefly of a Resident Country Director and a deputy. To assist in oversight of infrastructure projects, which account for more than half of MCC activities, MCC will often hire an independent engineering consultant. Close cooperation and guidance is also provided by MCC Washington headquarters expert staff at all points of implementation, on procedure as well as on sector technical support. MCC has to sign off on all major steps during implementation, including each disbursement. To reduce the risk of corruption, funding is transferred periodically and directly to contractors following a determination that project performance has continued satisfactorily. An appealing feature of MCC contracts to international contractor firms is that payment is made by the United States Treasury, not the compact country.

Following completion of a compact, as is the case with Honduras and Cape Verde which closed in 2010, and will be the case with five more in 2011, the MCC conducts impact evaluations using independent evaluators. Results of the first evaluations are expected to be made public within the year.

As projects are implemented, events may require that changes be made to compact plans. In 2007 and 2008, for example, the convergence of a depreciating U.S. dollar and rising costs for the machines and material necessary for the many infrastructure projects conducted by MCC meant that MCC projects were faced with having less funding than envisioned to meet the agreed-on objectives. At the time, at least six projects were scaled-back from original plans or supplemented by financing from other sources. In 2010, increased costs due to design changes and higher construction costs led to the re-allocation of nearly \$40 million for a Ghana transportation project. A re-allocation of project resources was made unnecessary when bids on Tanzania's rural roads came in higher than budgeted, because the Tanzania government committed funds to make up for the shortfall. The number of boreholes to be drilled under a rural water supply project in Mozambique was reduced from 600 to 300-400 because the amount allocated for construction

¹⁸ Marco Bogran, Acting General Director, MCA-Honduras, and Ariane Gauchat, Associate Director, MCC, *MCC Hosts Public Event: Lessons Learned from MCC's First Compacts*, February 22, 2011, pages 9 and 32.

were insufficient. Although the MCC is trying to address potential changes by requiring more frequent portfolio reviews and early identification of high risk projects, projects planned for a five-year life span are likely to undergo revision at some point. Changes in country policy performance, however, are less foreseeable and carry more serious consequences. These are discussed below.

Compact Suspension and Termination

Throughout the entire process from candidacy to eligibility through development and implementation of a threshold program or compact, countries are expected to maintain a level of performance on the criteria reasonably close to that which brought them to their MCC threshold or compact-eligible status. On more than one occasion and for a variety of reasons, MCC programs have been suspended or terminated.

Section 611(a) of the Millennium Challenge Act of 2003 provides that, after consultation with MCC's Board of Directors (Board), the CEO may suspend or terminate assistance in whole or in part if the CEO determines that (1) the country or other entity receiving MCC aid is engaged in activities which are contrary to the national security interests of the United States; (2) the country or entity has engaged in a pattern of actions inconsistent with the criteria used to determine the eligibility of the country or entity; or (3) the country or entity has failed to adhere to its responsibilities under its compact. This policy applies to MCC assistance provided through a compact, for compact development and implementation, and assistance through a threshold agreement.¹⁹ All compacts contain language providing that MCC may terminate the compact if the government engages in a pattern of action inconsistent with the criteria used to determine the eligibility of the country for assistance. This is the standard compact language that has been cited in most, if not all, prior MCC compact terminations.

In addition, all countries at all points of the process are affected by certain strictly applied foreign assistance restrictions in the Foreign Assistance Act of 1961 and in annual appropriations legislation. For example, restrictions on aid to countries whose governments are deposed by a military coup prevent countries from being considered for MCC candidacy, eligibility, or continued threshold or compact implementation.²⁰

Application of legislative restrictions varies according to circumstances. The MCC has four steps available to it as responses to any perceived violations of its performance rules. It may warn a country of its concerns and potential consequences. It may place a program or part of a program on hold. These actions are both preliminary steps that can be taken by management without immediate concurrence of the Board. The two further steps, suspension and termination, must be made by the Board of Directors.

In all cases when some possible violation of MCC standards has been brought to the attention of the agency, the MCC Department of Policy and Evaluation conducts a review of the evidence and presents it with a recommendation to the Board. The Board does not uniformly follow the recommendation made. If a determination is made to hold, suspend, or terminate, it may be further determined to affect a whole or only part of the compact.

¹⁹ "MCC Policy on Suspension and Termination", available at <http://www.mcc.gov/mcc/bm.doc/07-suspensionandterminationpolicy.pdf>.

²⁰ Most recently, section 7008 in P.L. 111-117, Division F, the State, Foreign Operations Appropriations, FY2010.

The MCC has suspended or terminated programs in the following cases:

- Threshold programs have been suspended or terminated in Niger, due to undemocratic actions taken by its leadership contrary to the MCC's governance criteria; Yemen due to a pattern of deterioration in its performance criteria; and Mauritania due to aid prohibitions on governments deposed by a coup. See Threshold Program section below for details.
- Compact eligibility was suspended in the Gambia because of "a disturbing pattern of deteriorating conditions" in half of the 16 qualifying factors.
- Compacts have been suspended or terminated, in whole or part, in Nicaragua, because of the actions of the government inconsistent with the MCC eligibility criteria in the area of good governance; in Honduras, because of an undemocratic transfer of power contrary to the Ruling Justly criteria; and in Madagascar, due to a military coup. In Armenia, MCC put a hold on a portion of the compact due to poor performance in a range of governance indicators, but the Board did not formally vote to suspend. See Compact Descriptions section below for details.

In as much as there have been only 23 compacts and 23 threshold agreements to date, the number of holds, suspensions, or terminations suggests that the MCC takes seriously its legislative mandate by moving to address violations of its performance standards. These prior instances of MCC program suspension and termination indicate that the MCC is most likely to apply Sec. 611(a) in response to an undemocratic transfer/retention of power, a violation of the Ruling Justly eligibility criteria. However, observers have noted instances in the past in which MCC has not taken action to restrict eligibility to countries with questionable records on political rights and civil liberties, for instance Jordan.²¹ And, as noted above, a number of compact countries have failed one or more of their qualifying indicators for one or more years in a row during the period of compact implementation.

Compact Descriptions

Descriptions and key developments in the 23 compacts are provided below in alphabetical order (also see **Table 3**). Compact funding totals include administrative and monitoring costs.

Armenia

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

Misgivings have been raised both prior to and during implementation of the Armenia compact. In September 2005, during compact development, the MCC expressed concerns with Armenian

²¹ Freedom House, Press Release, "Millennium Challenge Corporation Should Hold Countries to Higher Standards of Democratic Governance, November 2, 2006, available at <http://www.freedomhouse.org/template.cfm?page=70&release=435>; Sheila Herrling, Steve Radelet, and Sarah Rose, "Will Politics Encroach in the MCA FY2007 Selection Round? The Cases of Jordan and Indonesia," Center for Global Development, October 30, 2006, <http://www.cgdev.org>.

officials regarding slippage on two of the governance indicators and matters raised by international groups concerning political rights and freedoms in the country. Moreover, the MCC Board delayed final approval of the compact following the November 27, 2005, constitutional referendum, after allegations of fraud, mismanagement, limited access by the press, and abuse of individuals were raised. In signing the compact on March 27, 2006, the MCC issued a cautionary note, signaling that Armenia must maintain its commitment to the performance indicators or risk suspension or termination of the compact. On March 11, 2008, the MCC issued a warning that assistance might be suspended or terminated in response to the government's actions, including the imposition of a state of emergency and restrictions on press freedoms.²² In the autumn of 2008, the Armenian government used \$17 million of its own funds to begin a road segment when there was some question of whether the MCC would continue its support. In December 2008, then-MCC CEO Danilovich noted that Armenia had since moved forward on a number of reforms addressing MCC concerns and he expected MCC support to resume in the spring of 2009.²³ However, on March 11, 2009, the MCC Board of Directors declined to lift the funding hold for the rural roads component of the Armenia compact until an interim review session could be held prior to its normal June 2009 meeting in order to assess the status of democratic governance in Armenia. On June 10, 2009, the MCC Board allowed the hold to continue on financial support for the roads project. One board member noted that the hold on funding was, in effect, a termination, as the work, if reapproved, could not be completed within the compact lifespan.²⁴

Benin

The five-year, \$307 million compact focuses on four sectors—land rights, reducing the time and cost of obtaining property title; financial services, helping micro, small, and medium-sized businesses; justice reform, assisting the judicial systems capacity to resolve business and investment claims; and market access, improving the Port of Cotonou. The compact's goal is to benefit five million people, bringing 250,000 of the population out of poverty by 2015.

Burkina Faso

The five-year, \$480.9 million compact has four elements. A rural land governance project (\$59.9 million) will focus on improving legal and institutional approaches to rural land issues, including registration and land use management. An agriculture project (\$141.9 million) will target water management and irrigation, diversified agriculture, and access to rural finance in specific regions of the country. A roads project (\$194.1 million) will improve rural roads. The education effort (\$28.8 million) will build on the country's MCC threshold program and construct additional classrooms and provide daily meals to children. The education project will be administered by USAID.

²² See letters of John Danilovich to Armenia President Robert Kocharyan on December 16, 2005 and March 11, 2008 on MCC website.

²³ MCC, Public Outreach Meeting Transcript, December 12, 2008, p. 12.

²⁴ Lorne Craner at Public Outreach Meeting, June 11, 2009.

Cape Verde

The five-year, \$110 million compact, completed in October 2010, has focused largely on improving the country's investment climate, transportation networks, and agriculture productivity. The program's goal has been to increase the annual income in Cape Verde by at least \$10 million.

The compact evolved around three projects. In support of private sector development, \$2.1 million and additional participation with the International Finance Corporation was used to remove constraints to private sector investment by creating a commercial credit information bureau and stimulate other reforms. The MCC invested \$83.2 million primarily for port construction to help link the nine inhabited islands and roads and bridges to improve transportation links to social services, employment opportunities, and local markets. By investing \$11.4 million to increase the collection and distribution of rainfall water and strengthen agribusiness services, including access to credit, the project hoped to increase agricultural production and double the household income of farmers.

Cape Verde is the first compact country to be made eligible for a second compact.

El Salvador

The five-year, \$461 million compact addresses economic growth and poverty reduction concerns in El Salvador's northern region where more than half the population lives below the poverty line. Education as well as water and sanitation, and electricity supply (\$95.1 million); support for poor farmers and small and medium-sized business (\$87.5 million); and transportation, including roads (\$233.6 million) are the chief elements of program.

Georgia

The \$295 million, five-year agreement with Georgia, ended in April 2011. It focused on reducing poverty and promoting economic growth in areas outside of the capital, where over half the population lives in poverty. The compact was divided into two projects. The first and the largest component (\$211.7 million) concentrated on infrastructure rehabilitation, including roads, the north-south gas pipeline, water supply networks, and solid waste facilities. The Enterprise Development Project (\$47.5 million) financed an investment fund aimed at providing risk capital and technical assistance to small and medium-sized businesses, and support farmers and agribusinesses that produce commodities for the domestic market.

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

On September 4, 2008, the Bush Administration proposed a \$1 billion aid initiative for Georgia, of which one component was adding \$100 million to the existing compact. An amendment to the compact was signed on November 20, 2008. Complementing or completing projects begun in the original compact, it is directed at road projects, water and sanitation facilities, and a natural gas storage facility.

Georgia has been selected as eligible for a second compact.

Ghana

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

Ghana has been selected as eligible for a second compact.

Honduras

The five-year, \$205 million (originally \$215 million) compact with Honduras, completed on September 17, 2010, focused on two objectives—rural development and transportation. The rural development project, representing \$68.3 million of the compact, assisted small and medium-size farmers to enhance their business skills and to transition from the production of basic grains to more high-value horticultural crops, such as cucumbers, peppers, and tomatoes. The project provided farmers with the appropriate infrastructure and necessary training for producing and marketing these different crops. More than 7,000 farmers were trained, of which 6,029 significantly increased production of horticulture crops. About 422 kilometers of rural roads were also upgraded, helping farmers transport their goods to markets at a lower cost. The original objective was 1,500 kilometers, but increased construction costs limited that figure.

The transportation project, totaling \$119.2 million of the compact, sought to improve the CA-5 major highway linking Honduran Atlantic and Pacific ports and major production centers in Honduras, El Salvador, and Nicaragua. Almost 50 kilometers of the CA-5 were completed of 107 originally planned and 45 of 68 kilometers in secondary roads before an undemocratic change in government contrary to MCC's Ruling Justly criteria—the removal of President Zelaya from office by a coalition of civilian and military institutions—led to the September 9, 2009, MCC termination of these two planned activities in the transportation sector. The termination affected about \$10 million in funding, including \$4 million for the CA-5 road project. Already contractually obligated programs were continued.²⁵

Honduras has not been selected as eligible for a second compact due to concerns over governance.

Jordan

The five-year, \$275.1 million compact is solely aimed at the water sector. In the governorate of Zarqa, it will reduce water loss by rehabilitating the water supply and distribution network from reservoir to household (\$102.5 million) and will improve the sewage system by replacing or

²⁵ See MCC Congressional Notification, September 17, 2009, at <http://www.mcc.gov/mcc/bm.doc/cn-091709-honduras.pdf>.

rehabilitating sewage lines (\$58.22 million). In a partnership with the private sector, the compact will also expand a wastewater treatment plant originally built by USAID (\$93.03 million).

Lesotho

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

Madagascar

The Madagascar compact, MCC's first signed agreement, started out as a four-year, \$110 million program, was extended to five years because of start-up delays, and then terminated prematurely because of a coup. The project had three objectives: (1) to increase land titling and land security (\$36 million), (2) to expand the financial sector and increase competition (\$36 million), and (3) to improve agricultural production technologies and market capacity in rural areas (\$17 million). After restoring 149,000 land rights documents, digitizing another 128,000, formalizing land rights for 12,800 families, constructing two new bank branches, and providing agriculture technical assistance to 34,450 farmers and 290 small businesses and farmers associations, the compact ended in May 2009, with little more than a year remaining in the compact's five-year span and \$88 million of the \$110 project committed.

Malawi

The five-year, \$350.7 million Malawi compact focuses on just one sector—electric power. The program aims to reduce power outages, reduce costs to business and homes, and improve the economic environment. One element will upgrade and modernize generation and distribution capacity (\$283 million); another will reform electric power supply institutions in the country (\$25.7 million).

Mali

The five-year, \$461 million compact emphasizes an increase in agricultural production and expansion of trade. About half the funds (\$234.6 million) support a major irrigation project, including modernization of infrastructure and improvements in land tenure. Improvements in the airport (\$89.6 million) target both passenger and freight operations. Due to rising construction costs and changes in currency valuations, \$94.6 million in funds originally intended for construction of an industrial park at the airport have been reallocated to the airport project.

Moldova

The five-year, \$262 million compact addresses agriculture and roads. On the agriculture side, \$101.77 million will be provided to repair large irrigation systems supporting high-value fruits and vegetables, to support the legal transfer for these systems to water user organizations, to facilitate financing facilities for farmers and entrepreneurs. USAID will provide technical assistance to improve market access for high-value agriculture. The compact will also provide \$132.84 million to repair a major bridge and highway leading toward Ukraine, facilitating commercial traffic between the two countries.

Mongolia

The most significant part of the original five-year, \$285 million compact was intended to stimulate economic growth by refurbishing the rail system, including infrastructure and management (\$188.38 million). However, in April 2009, the government of Mongolia informed the MCC that it would not be able to implement the \$188 million rail component of its compact, because Russian members of the joint Mongolian-Russian rail company would not allow an audit of the company.

The MCC has decided to use \$52 million of this amount to expand the three other original projects in the compact. These include support for improvements in the property registration and titling system (\$23.06 million) and the vocational education system (\$25.51 million), and an attempt to reform the health system to better address non-communicable diseases and injuries, which are rapidly increasing in the country (\$17.03 million). In December 2009, the MCC Board approved a further restructuring of the compact, utilizing remaining funding from the terminated rail component of the compact to target \$47.2 million at energy and environmental projects and \$79.7 million at rehabilitating a road and bridge.

Morocco

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

Mozambique

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

Namibia

The five-year, \$304.5 million compact focuses on education, tourism, and agriculture. The education project (\$145 million) will improve school infrastructure and training, vocational and skills training, and textbook acquisition. The tourism project (\$67 million) will target management and infrastructure in Etosha National Park, the premier wildlife park in Namibia, and build ecotourism capacity in the country. The agriculture project (\$47 million) will focus on land management, livestock support, and production of indigenous natural products.

Nicaragua

The five-year, \$175 million compact with Nicaragua, ending in May 2011, focused on promoting economic growth primarily in the northwestern region of the country, where potential opportunities exist due to the area's fertile land and nearby markets in Honduras and El Salvador. The compact had three components: (1) to strengthen property registration (\$26.5 million), (2) to upgrade primary and secondary roads between Managua and Leon and to provide technical assistance to the Ministry of Transportation (\$92.8 million), and (3) to promote higher-profit agriculture activities, especially for poor farmers, and to improve water supply in support of higher-value sustainable agriculture.

On June 10, 2009, the MCC Board voted to terminate assistance for activities not yet contracted under the Nicaragua compact. These activities had been suspended since the end of 2008 because of the actions of the Nicaraguan government inconsistent with the MCC eligibility criteria, specifically in the area of good governance. Nicaragua first received a warning, then projects were put on hold, and then activities not yet contracted were suspended in December 2008 as the credibility of Nicaragua's municipal elections was seriously questioned. In July 2009, due to government actions that "limited the activity of political opposition, civil society, media elections and observers" prior to the municipal elections,²⁶ and were judged by MCC to be a pattern of action "inconsistent with the criteria used by MCC to determine eligibility for assistance,"²⁷ compact funding was partially terminated. The termination affected activities not yet contracted, a property regularization project and a major road, together amounting to about \$62 million.

Philippines

The five-year, \$434 million compact has three components. Computerization of the revenue collection process is expected to raise tax revenues and reduce tax evasion, while improving the impartiality of tax administration (\$54.4 million). Support for small-scale, community development projects, designed and implemented by rural communities, is intended to strengthen local governance and participation in development activities (\$120 million). Rehabilitation of 222 kilometers of road linking two provinces is meant to reduce transport costs and increase incomes (\$214.4 million).

²⁶ MCC Press Release, "MCC Urges Nicaraguan Government to Respect Democracy," available at <http://www.mcc.gov/mcc/countries/nicaragua/ni-documents/release-112508-nicaragua.shtml>.

²⁷ From Nicaragua country page of MCC website, available at <http://www.mcc.gov/mcc/countries/nicaragua/index.shtml>.

Senegal

The five-year, \$540 million compact targets two infrastructure needs—roads and irrigation, both largely intended to support the agricultural sector in Senegal. The road rehabilitation project (\$324 million) seeks to improve two key roads, one connecting major towns and neighboring countries to the capital and the other connecting the agricultural area of the Casamance to the rest of Senegal. The irrigation project (\$170 million) will develop up to 10,500 hectares of land and prevent abandonment of 26,000 hectares. It will also address land tenure issues.

Tanzania

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

Vanuatu

The \$65.7 million, five-year compact, completed in April 2011, targeted improvements broadly in multiple types of infrastructure, including roads, wharfs, an airstrip, and warehouses. The objective was to increase the average per capita income by 15%, by helping rural agricultural producers and providers of tourism-related goods and services. The compact further aimed to help strengthen Vanuatu's Public Works Department in order to enhance capacity to maintain the country's entire transport network.

Anticipated Compacts in FY2011 and FY2012

In addition to the compact signed with Malawi in April 2011 (discussed above), the MCC anticipates possible approval of compacts with Zambia, Cape Verde, Indonesia, Ghana, and Georgia in FY2011 and FY2012. At this stage, the government of Zambia has conducted an analysis of poverty reduction strategies and has identified issues that will help guide its future compact proposal. Cape Verde is developing a second compact. A compact with Indonesia was anticipated for FY2012, but budget cuts and other considerations may mean a smaller grant with Indonesia is approved in FY2011, leaving the other countries to compete for FY2012 funding.

Threshold Programs

In order to encourage non-qualifying countries to improve in weak areas, the MCC has helped governments that are committed to reform to strengthen their performance so that they would be more competitive for MCC funding in future years. Congress provided in authorizing legislation that not more than 10% of MCC appropriations could be used for such purposes, stating that the

funding could be made available through USAID. Subsequent foreign operations appropriations have made 10% of new MCC appropriations available for this so-called threshold assistance.²⁸

In the first part of 2010, the threshold program underwent a review, the conclusions of which have only recently begun to emerge and have not yet been published in formal policy guidance. Up through mid-2010, the threshold programs sought chiefly to assist countries make policy reforms and institutional changes in areas where they failed to meet the MCC performance criteria with the stated goal of helping them improve those indicators. Those countries deemed eligible for the program had to submit concept papers identifying where and why the country failed to pass specific indicators; make proposals for policy, regulatory, or institutional reforms that would improve the country's performance on these indicators; and note types of assistance, over a two-year maximum period, required to implement these reforms. If the MCC, in consultation with USAID, determined that the concept paper showed sufficient commitment to reform and a promise of success, the country would prepare a threshold country plan that specifically established a program schedule, the means to measure progress, and financing requirements, among other considerations. USAID has been charged with overseeing the implementation of nearly all threshold country plans, including working with countries to identify appropriate implementing partners such as local, U.S., and international firms; NGOs; U.S. government agencies; and international organizations. Like regular MCC compacts, funding is not guaranteed for each country selected for the threshold program, but is based on the quality of the country plan.

Although eight threshold country programs have been followed by compact eligibility, some Members of Congress and others raised concerns regarding the efficacy of threshold programs. It has been variously argued that two years is insufficient time to alter the indicators; that some countries passed the indicators before the threshold program could begin; that, by funding reform to improve an indicator, the threshold program undermines the principle that countries should themselves be responsible for reform and MCC eligibility; and that programs should focus on better preparing countries to implement compacts rather than on enabling them to qualify for eligibility.²⁹ In response to an explanatory statement accompanying the FY2009 Omnibus appropriations that suggested an assessment of the programs be undertaken before more are approved, the MCC did not select any new countries for threshold eligibility for FY2010 and did not request funding for the program in its FY2011 budget.

The MCC briefed its board in June 2010 and announced in September 2010 a new approach to threshold programs. While maintaining the basic purpose of helping countries become compact-eligible as required by the authorizing language, the MCC will no longer focus on changing specific indicator scores. Rather, it will focus on constraints to economic growth, like those identified for compact countries, but maintain the former threshold program focus on reforming policies. Working on resolving constraints to growth would have the benefit of helping MCC and the board become more familiar with potential compact countries as well as of beginning to work on policy reforms for problem sectors that would likely be among the ones addressed in compact projects. Despite this statement of policy, the MCC has not selected new eligible countries for the FY2011 round and requested no threshold funding for FY2012.

²⁸ Initially, assistance for threshold countries was authorized only for FY2004.

²⁹ One such critic, Sheila Herrling, has since become the MCC Vice President for Policy and Evaluation. See "Precedent-Setting Board Meeting for Team Obama," *MCA Monitor Blog*, June 9, 2009, Center for Global Development website <http://blogs.cgdev.org/mca-monitor>.

To date 23 threshold programs worth a total of about \$495 million have been awarded to 21 countries, two of which have received second programs. Currently 6 countries are receiving threshold assistance: Rwanda, Liberia, Albania (second program), Timor-Leste, Paraguay (second program), and Peru. Of those countries that have completed programs, Indonesia, Moldova, Burkina Faso, Jordan, Malawi, the Philippines, Tanzania, and Zambia, have either begun or are eligible for compacts.

Threshold countries are subject to the same performance rules as compact countries. Two countries—Mauritania and Yemen—have had their threshold eligibility terminated prior to program implementation, the former because of a coup and the latter due to deterioration in qualifying indicators.³⁰ One country—Niger—had its active threshold program suspended as its governance performance deteriorated.³¹

Funding levels for threshold programs differ, ranging from \$6.7 million for Guyana to \$55 million for Indonesia. Of the programs ongoing or completed, most have sought to improve country scores on the corruption indicator. Several countries have multiple objectives. Indonesia and Peru, for example, target both corruption and immunization indicators. Liberia's program focuses on girls' education and land rights. Timor-Leste targets corruption and childhood immunization.

Select Issues

Concerns regarding the MCC have been expressed at various points in time on its level of funding, the speed of program implementation, the size of compacts, the sectors supported, impact on development, the role of USAID, aspects of procurement, and the risk of corruption. These issues are discussed below.

³⁰ Mauritania, made eligible in 2007, saw its eligibility terminated in 2008, prior to development of a threshold program agreement, due to aid prohibitions on governments deposed by a coup. Yemen, made threshold eligible in 2004, was suspended by the Board in November 2005, as a result of a consistent "pattern of deterioration" in its policy performance on selection criteria.³⁰ Following a series of government reforms, Yemen's threshold status was reinstated in February 2007 and a threshold agreement valued at \$20.6 million was approved in September 2007. In October 2007, however, the Chair and ranking member of the Senate Foreign Relations Committee noted their concern regarding the Yemen decision, in particular noting that, while Yemen had made reforms, its performance indicators had not yet shown improvement. The Members emphasized that, even if the MCC moved forward with the Yemen threshold program, "such compromises should never extend to the Compact program itself." In the end, implementation was postponed on October 27, 2007, pending a review, and its program has never been resumed.

³¹ In September 2009, the MCC Board warned that Niger appeared to be moving away from its reform agenda, jeopardizing its \$23 million threshold program. Niger's threshold program was suspended in December 2009 due to "political events that were inconsistent with the criteria used to determine eligibility for MCC assistance," when President Tandja dissolved parliament and dismissed the constitutional court after it ruled that a referendum to extend his presidential term was illegal. See MCC Congressional Notification, December 17, 2009, available at <http://www.mcc.gov/mcc/bm.doc/cn-121709-niger.pdf>.

Table 2. MCC Appropriations: FY2004-FY2012

(in \$ billions)

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Request	1.300	2.500	3.000	3.000	3.000	2.225	1.425	1.280	1.125
Enacted Appropriation	0.994	1.488	1.752	1.752	1.544	0.875	1.105	0.900	
Post-Rescission Appropriation	0.989	1.480	1.751	1.746	1.484	0.871	1.081	0.898	

Note: P.L. 110-252 rescinded \$58 million in FY2008 appropriation. P.L. 111-226 rescinded \$50 million from unobligated amounts; MCC applied it to the 2004-2010 fiscal years. H.R. 1473 includes an across-the-board 0.2% rescission.

Funding

When the MCC was proposed, it was expected that, within a few years, the level of funding would ramp up to about \$5 billion per year. For a variety of reasons, not least of which is the limitation on available funding for foreign aid, the MCC never achieved anywhere near that level of funding. In fact, in each year since the MCC was established, its enacted appropriation has been well below the President's request. At \$1.1 billion, the FY2010 pre-rescission appropriation was \$320 million or 22% below the request. The FY2011 pre-rescission appropriation of \$900 million is 30% below the request and the second lowest appropriation in its eight-year history.

In determining the appropriation level, Congress has to weigh the benefits of the MCC program against all other foreign assistance programs as well as against other non-foreign policy needs. A consequence of diminished appropriations is that the agency may provide fewer compacts each year to fewer countries than originally anticipated. An additional effect may be that, if few compacts are offered annually, the incentive for countries to reform on their own in order to meet eligibility requirements—the so-called MCC effect—could be lost.

MCC Appropriations Request and Congressional Action for FY2011

On February 1, 2010, the Obama Administration issued its FY2011 budget, requesting \$1.280 billion for the MCC, a 16% increase over the FY2010 pre-rescission appropriation level. On June 30, the House State, Foreign Operations Appropriations subcommittee approved a draft FY2011 bill, never reported out of committee. The bill would have provided \$1.105 billion for the MCC. On July 29, the Senate Appropriations Committee reported S. 3676, the FY2011 State, Foreign Operations appropriations, also providing \$1.105 billion for the MCC, \$174.7 million below the request and equal to the FY2010 appropriation level. The Senate bill also contained extensive amendments to the MCC authorization (see below).

Following a series of continuing appropriations, in April 2011, Congress approved H.R. 1473 (P.L. 112-10), providing \$900 million for the MCC. After applying a .2% across-the-board non-defense rescission, the MCC receives \$898 million in FY2011, a 19% decrease from the FY2010 enacted level.

On August 10, 2010, Congress rescinded \$50 million from unobligated balances of the MCC in FY2009 and prior fiscal years, one of dozens of rescissions included in P.L. 111-226, an act that funded a number of domestic programs.

MCC Appropriations Request and Congressional Action for FY2012

In February 2011, the Obama Administration issued its FY2012 budget, requesting \$1.125 billion for the MCC, a 2% increase from the enacted FY2010 appropriation and a 25% increase over the final FY2011 appropriation.

Authorizing Legislation and MCC Reform

Although the requirement of an authorization of foreign aid programs has been routinely waived in annual Foreign Operations appropriations bills, as the FY2011 Continuing Appropriations measure did in the case of currently unauthorized foreign aid programs, including the MCC (section 1108, P.L. 112-10), it is possible that an MCC reauthorization measure will be considered in the 112th Congress.

A previous effort, in the 109th Congress (2006), was reported by the House International Relations Committee (H.R. 4014, H.Rept. 109-563), but received no further consideration. That bill would have made a number of policy modifications to the original legislation and would have authorized MCC appropriations (“such sums as may be necessary”) for fiscal years 2007 through 2009. Early in 2010, the Administration proposed a number of changes to MCC legislative authorities, including provisions on eligibility of countries moving from one income status to another, compact extensions, and concurrent compacts. Provisions on these issues were included in section 609 of the Foreign Relations Authorization Act, S. 2971 (Kerry), introduced on January 29, 2010, and were largely maintained in section 405 of the amended version of S. 2971 reported by the Senate Foreign Relations Committee on April 27, 2010. A somewhat similar set of authorization provisions was included in section 7075 of the Senate version of the FY2011 State, Foreign Operations appropriations, S. 3676.

With regard to the MCC, these two pieces of legislation would have

- extended the potential eligibility of selected countries that transition from low-income status to lower-middle income status, or the reverse, as though they remained in their former income status for the year of transition and two subsequent years. S. 3676 requires retention of the former status; S. 2971 allows it. This provision addresses a matter raised first in the FY2010 Consolidated appropriations (H.R. 3288, P.L. 111-117). However, the latter also allowed countries that moved in FY2009 to the upper-middle-income class, a group technically banned from MCC assistance, to maintain their lower-middle status for several years. No such provision is included in either S. 3676 or S. 2971.
- allowed a compact to exceed five years in length, up to seven years. This provision is deemed necessary in view of the difficulties that recipient countries may have in implementing complex projects within a limited timeframe.
- allowed two concurrent compacts (more than one at the same time), in order to give the MCC flexibility to do smaller, staggered projects, instead of wrapping them all in one compact. The MCC argues that concurrent compacts could be

implemented as a recipient country is prepared to do so, thereby speeding up the implementation process. For example, some infrastructure projects require more planning than do technical assistance projects. S. 3676 contains additional provisions that would allow concurrent compacts only up to two years after an initial compact and would limit compact funding to any one country to 15 years.

- redefined low- and lower-middle income status to place the lowest 75 countries in the low-income group and the remaining lower-middle income countries in the lower-middle income level. Without this change, there would be 55 countries in the low-income and 29 in the lower-middle level in FY2011. This move is a response to the continually shifting classification of candidate countries that determines who they compete against for compact eligibility and the level of funding available to support their compacts (only 25 % of appropriations are available to the lower-middle group each year).

Some form of these authorization proposals may be considered in the 112th Congress.

Compact Size

During its first five years, the MCC was criticized for supporting compacts that were either too small or too large based on the dollar size of the grants. A closely examined characteristic of the early compacts was their lower-than-anticipated funding level. While Bush Administration officials had said repeatedly that compacts would be funded at various levels depending on the nature and potential impact of the proposal, the presumption in its first years was that the MCC grant would represent a sizable increase in U.S. assistance to the eligible country. In order to realize its potential as a “transformational” aid program and to provide sufficient incentives to countries requesting “breakthrough” projects, the MCC said that the size of its grants must place MCC assistance among the top aid donors in a country.³² Some had estimated that once the Corporation’s budget reached the \$5 billion annual level originally suggested, each compact would be supported with annual resources in the \$150-\$200 million range.³³ These levels could vary up or down depending on many factors, such as the number of people living in poverty, the size of the economy, and the scope of the proposed projects.

Most of the first several compacts, however, did not meet the anticipated financial allocation thresholds. Madagascar’s four-year, \$110 million compact roughly doubled U.S. assistance to the country, but did not place MCC assistance among the top donors. France was the largest bilateral donor, disbursing on average \$189 million per year, 2001-2004. The European Commission’s aid program, 2001-2004, averaged \$82 million per year, while the World Bank’s International Development Association was Madagascar’s largest source of concessional assistance of about \$209 million lent in each of 2001 through 2004.³⁴ The \$110 million compact for Madagascar was also not very large relative to the country’s population. Of the 16 qualified countries for FY2004, Madagascar had the fourth largest population (16.4 million), and might have been expected to receive one of the larger MCC grants given its population size and its per capita income.

³² See, for example, Millennium Challenge Corporation FY2005 Budget Justification, p. 7. Found at http://www.mcc.gov/about/reports/congressional/budgetjustifications/budget_justification_fy05.pdf.

³³ Prepared statement of Steve Radelet, Senior Fellow at the Center for Global Development, before a hearing of the House International Relations Committee, April 27, 2005.

³⁴ Organization for Economic Cooperation and Development (OECD), *Geographical Distribution of Financial Flows to Aid Recipients, 2000/2004*: 2006 edition.

For Honduras (a \$215 million MCC program over five years), Georgia (\$295 million over five years), and Armenia (\$236 million over five years), the United States was the top bilateral donor without the MCC program, and will likely remain in that position as MCC grants are disbursed. But the MCC Compact for Honduras called for only a slightly higher annual amount (\$43 million) than U.S. economic assistance provided (\$34 million) at the time, while Georgia's compact averaged only about three-fourths and the Armenia compact only about two-thirds of the annual level of their recent American aid. While these were not insignificant amounts of new resources, they were far less than Bush Administration officials had suggested previously.³⁵

In contrast, the early five-year compacts with Cape Verde (\$110 million), Benin (\$307 million), and Vanuatu (\$66 million) represented a substantial investment by the United States, relative to the size of recent American aid and the size of their economies. USAID, which last provided direct bilateral assistance to Cape Verde in the mid-1990s, does not maintain a mission presence, allocating small amounts of aid through regional programs. The compact's \$22 million annual average placed the United States second to Portugal, Cape Verde's former colonial power, as the leading donor, and represented more than a quarter of total bilateral development aid grants from all sources compared with figures for 2003 and 2004. Likewise, the United States does not maintain a bilateral program with Vanuatu, limiting direct aid to the Peace Corps. The \$13 million annual average of the Vanuatu program places the United States as the country's top aid donor, along with Australia. In Benin, USAID manages an annual bilateral economic aid program of about \$15 million, compared with the \$61 million annual size of the MCC compact. The Benin compact likely places the MCC as the top aid donor, together with France.³⁶

This issue of compact size was a priority of Ambassador Danilovich following his September 2005 confirmation hearing to be the MCC's new CEO. He noted that the MCC was "meant to create transformative programs," and to do so he said that "future compacts will generally need to be larger than those signed thus far." Ambassador Danilovich cautioned, however, that with limited resources but larger compacts, fewer countries would receive funding if MCC was to achieve its transformational goal.³⁷ After assuming the CEO position, he moved the MCC towards larger compacts and placing the MCC as the largest donor in recipient countries. In 2005, the average amount of compacts signed in that year was \$181 million, in 2006, \$364 million, in 2007, \$463 million, and in 2008, \$495 million.

Apparently, in the view of some in Congress, the move to larger compacts went too far. In the explanatory statement accompanying the FY2009 Omnibus appropriations (P.L. 111-8), the MCC was urged to limit compact size to under \$350 million in order to "ensure that the MCC does not become overextended, that existing compacts are meeting their goals, and future compacts are of a manageable size."

Speed of Implementation

A recurrent criticism of the MCC, especially in Congress, has been the seemingly slow speed of implementation, reflected, in the view of some, by the limited amount of disbursements relative

³⁵ For example, USAID Administrator Natsios remarked in an October 22, 2002 speech at the American Embassy in London that "we estimate in most countries the MCA will provide funding 5 to 10 times higher than existing levels" of U.S. assistance.

³⁶ *Geographical Distribution of Financial Flows to Aid Recipients, 2000/2004: 2006 edition.*

³⁷ Prepared statement of John J. Danilovich, before the Senate Committee on Foreign Relations, September 27, 2005.

to available funds. This view is, to some extent, a cause of cuts in MCC funding from the Administration request and of threatened rescissions from amounts already appropriated during the past few years. As of the end of September 2009, of the \$6.4 billion obligated for MCC compacts up to that point, only \$889 million, or 14%, had been disbursed.

There are some good reasons for this spending rate. The MCC was a new initiative, and it took time to develop methods of operation, including settling on the rules of eligibility and the requirements of compact proposals. Further, the countries themselves are responsible for developing proposals, and they have problems common to most developing countries in managing complex programs to meet donor requirements of accountability. The GAO found that for five signed compacts in Africa—Madagascar, Cape Verde, Benin, Ghana, and Mali—the process of going from eligibility to compact signature took between 12 and 31 months. Four of these compacts entered into force about five months after compact signature.³⁸

Once launched, compacts may be slow to get underway. For example, Honduras and Cape Verde, both in their fourth year had disbursed only 29% and 40%, respectively, of their total grants by end of March 2009. Among the causes for these low rates are delays by compact countries in filling managerial positions. The nature of many of the compacts is also responsible for the delays. Typically, infrastructure projects are slow to disburse funds in the early years, the majority of activity being the design and planning of projects rather than actual construction.

Whatever the causes, the MCC responded to the criticisms by shifting its organizational focus from the early emphasis on compact development to compact implementation. In October 2007, it announced a reorganization aimed at facilitating implementation. Spending has speeded up in the past year, representing 28% of total compact obligations as of September 2010.

Compact Sectors

One feature of the first series of compacts drew particular attention. Most of the early compacts included a similar sector concentration, focusing on agriculture and transportation infrastructure projects. While these activities are well justified, the similarity across Compacts surprised some observers. Given the wide diversity of conditions in each of the countries, plus the MCC's willingness to support all types of programs—the agency's only requirement is that projects be able to project the amount of economic growth and poverty reduction that will be generated—many had expected to see a greater degree of variation among the compacts. Some believe that social sectors, including those in health and education, should be receiving greater attention in compact design. Others had expected greater variety in aid delivery mechanisms, and are concerned that the MCC is reluctant to approve sector grants and other types of budget support assistance. While there can be greater accountability risks associated with budget support aid, countries that qualify for MCC support are selected because they have already demonstrated stronger performance in managing resources and fighting corruption.³⁹

As more compacts are signed, some diversity in programs is creeping in—four of the more recent ones, in Lesotho, Mozambique, Tanzania, and Jordan, feature a water and sanitation component.

³⁸ Government Accountability Office, *Millennium Challenge Corporation: Progress and Challenges with Compact in Africa*, Testimony, June 28, 2007, GAO-07-1049T.

³⁹ James Fox and Lex Rieffel, *The Millennium Challenge Account: Moving Toward Smarter Aid*. The Brookings Institution, July 14, 2005, p. 24.

The Morocco compact includes micro-credit and artisan crafts support among its projects. Burkina Faso and Namibia have education components.

Compact Outcomes and Impact

The MCC places considerable weight on demonstrating results. During project development, it predicts a set of outcomes that help determine which projects will be funded. During implementation, it gathers data to establish baselines and monitor performance. And, at project completion, it supports independent evaluations of achievements. It promises to release these findings to the public, regardless of the results, with the intention of improving the agency's performance in meeting its purpose of reducing poverty through economic growth.

In its first seven years of existence, however, some observers have complained about the lack of measurable results.⁴⁰ There are some possible reasons for this, most prominently the slow speed of compact implementation noted above. The first compact programs have only just ended in late 2010. As a result, it will likely be some time before a serious analysis of actual impacts can be undertaken. In the meantime, some reporting on outcomes has emerged. For instance, according to the MCC, the number of new registered businesses in Albania has grown by 20,000, and the time and cost of starting a business in Paraguay has fallen by nearly half. In March 2009, the MCC issued an independent impact analysis of the Burkina Faso Threshold Program, which constructed 132 primary schools and provided other assistance to increase girls' enrollment rates. It found that enrollment increased for both genders, by about 20%, and for girls over boys, by 5%.⁴¹ With the recent completion of compacts in Honduras, Cape Verde, Vanuatu, and Georgia, close of compact independent assessments are expected to more thoroughly enumerate outcomes and impacts.

A 2007 GAO report highlighted a concern, that, in the case of Vanuatu, projected impacts had been overstated. The GAO noted that the MCC estimated a rise from 2005 per capita income in Vanuatu of about 15% (\$200) by 2015 when the data suggest it would rise by 4.6%. Although the MCC states that the compact would benefit 65,000 poor, rural inhabitants, the data, according to the GAO, do not establish the extent of benefit to the rural poor. Further, the MCC projections assume continued maintenance of projects following completion, whereas the experience of previous donors is that such maintenance has been poor.⁴² The MCC response was that, although there may be varying views on the degree of benefit, both agencies agree that the underlying data show that the compact will help Vanuatu address poverty reduction.⁴³

⁴⁰ For example, the Senate Appropriations Committee report (S.Rept. 110-425) on its version of the FY2009 State/Foreign Operations appropriations explained a proposed cut to the MCC by noting the small compact disbursement rate (4% of total compact funding at the time) and the lack of tangible results to date as factors. The committee stated its intention to support future compacts "if current country compacts are shown to be cost effective and achieving results."

⁴¹ MCC Public Board Meeting, June 11, 2009. Mathematica Policy Research, Inc., *Impact Evaluation of Burkina Faso's BRIGHT Program*, March 2009.

⁴² Government Accountability Office, *Millennium Challenge Corporation: Vanuatu Compact Overstates Projected Program Impact*, July 2007, GAO-07-909.

⁴³ Testimony of Rodney Bent before the House Committee on Foreign Affairs, Subcommittee on Asia, the Pacific, and the Global Environment, July 26, 2007.

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

Role of USAID

How USAID would participate in the MCC initiative was a concern of Congress and members of the development community when the MCC was established. Section 615 of the MCC authorizing legislation requires the Corporation's CEO to coordinate and consult with USAID and directs the Agency to ensure that its programs play a primary role in helping candidate countries prepare for MCC consideration. USAID maintains missions in most of the eligible countries and might be expected to support MCC programs in some way.

USAID's role to date has varied. In cases where there is a USAID mission, the views of mission personnel on potential compact proposals have been requested, and several MCC projects appear to expand on activities from earlier USAID projects. In Namibia, for example, the MCC based its community-based natural resource management efforts on USAID's successful efforts to establish conservancies. Almost all MCC threshold programs have been implemented by USAID, and USAID is the implementor of the Burkina Faso compact education project, continuing efforts it led in that country's threshold program to increase primary school completion rates for girls.

One question of concern to the development community is how USAID would adjust its own programs in countries receiving MCC compacts. Then-USAID Administrator Natsios told the House Appropriations Committee on May 13, 2004, that the Agency would not withdraw from or cut programs in MCC countries, but would not increase spending either. Nonetheless, some critics continue to express concern that MCC funding is not always additive, as had been the pledge, but substitutes for portions of previous USAID bilateral development aid programs. In its FY2008 report on the State/Foreign Operations bill (H.Rept. 110-197), the House Appropriations Committee expressed the view that MCC aid should be "a complement," not a substitute, to the current aid program.

Procurement Policy

In the course of implementing compacts, the entity that MCC sets up with partner governments signs hundreds of contracts each year to procure equipment, construct infrastructure, or obtain technical expertise. Under MCC rules, compact procurement processes are based on World Bank procedures, not U.S. federal acquisition requirements or the compact country's own rules. To counter corruption, build capacity, and achieve the maximum value for the cost of goods and services, MCC-approved rules feature transparent, competitive bidding from all firms, regardless of national origin. According to the MCC, companies from 54 countries have won MCC procurement contracts, U.S. firms winning the most with 15% of the total.

In August 2010, Senator Jim Webb raised the concern that some of these contracts had been won by Chinese government-owned firms. In a letter to the MCC, he argued that contracts awarded to

Sinohydro Corporation for construction work in Mali and Tanzania supported Chinese foreign policy efforts to expand influence in Africa and harmed U.S. business. In October 2011, the MCC amended its procurement guidelines to prohibit contracts with state-owned enterprises (SOEs), except in the case of educational, research, and statistical units of government not formed for a commercial purpose. Its chief stated reason for making the change is to ensure a level playing field for competing firms. As of June 30, 2010, \$325 million or about 10% of MCC contracts had gone to SOEs.

Corruption

With developing countries themselves implementing MCC-funded programs, corruption is a major concern of the MCC, in the selection process, in threshold programs, and in compact implementation.

Aiming to safeguard U.S. aid dollars, MCC programs are designed to prevent corrupt contracting. Among other things, MCC requires a transparent and competitive process and mandates separation of technical and financial elements of a bid. The MCC reviews each decision made by the procurement entity and must register approval for many of them, and it provides funds directly to contractors rather than through the government implementing entity. MCC argues that, in following this process, recipient governments learn how to do procurement in a corrupt-free way.

The degree to which a country controls corruption is one of the performance indicators that help determine whether a country should be eligible for compact funding. In fact, it is the only “pass-fail” indicator. Passing the indicator, however, does not mean there is little or no corruption—an unrealistic expectation for most developing countries. It only demonstrates that a country’s performance is above the median relative to other countries at the same economic level. Further, as suggested in the discussion of country selection, the MCC board does not depend on indicator scores alone to determine the selection process. These scores change from year to year, depending on fresh data and the relative scores of competing countries. Taking this into account, the MCC board uses discretion by looking at a number of factors, including the many underlying data sources that make up indicators, as well as recent steps taken by the government in question to address corruption (or, in some cases, recent increased allegations of corruption). Accordingly, a country can be selected that technically falls near or below the median if mitigating factors occur. Alternatively, countries that pass the corruption indicator may be the subject of intense debate over incidences of alleged corruption. Because of data lags, countries passing the indicator may fail a year or two later, once a compact is in place. This can be true of all the indicators, particularly when a country “graduates” into a higher income category, thereby changing the medians. The MCC attempts to address this concern by looking for a pattern of behavior on the part of the government in order to judge the severity of any proposed corrective action.

In 2010, there were suggestions from Congress that the MCC should take the issue of corruption more into account in judging compact country behavior. During hearings with the MCC CEO, the House State, Foreign Operations Appropriations Sub-committee Chair and Ranking Member raised concerns regarding the absence of termination guidelines based on a pattern of corruption.⁴⁴

⁴⁴ Hearing with Daniel Yohannes, MCC CEO, April 14, 2010.

In 2009 and 2010, several members of Congress noted their concern regarding provision of MCC funding to corrupt countries.⁴⁵ Specifically, they each referred to the case of Senegal, whose leader installed a monument to the country's independence estimated to cost between \$24 million and \$70 million. The \$540 million compact with Senegal was signed in September 2009. Despite corruption reports, Senegal scores in the 74th percentile of the FY2011 Control of Corruption indicator formulated by the World Bank. The MCC says it has looked at but found no pattern of corrupt behavior since signing the Senegal compact that would justify suspending or closing the compact program. It has notified the Senegalese government that any decline in policy performance, regardless of indicator scores, could jeopardize the compact.

⁴⁵ "For Senegal: U.S. Aid, 164-ft. Statue," *The Washington Times*, August 16, 2010.

Table 3. MCC Compacts

Country	Compact Signed	Compact Size (millions)	Entry Into Force	Compact Focus	GNI per capita	Population Living Below \$2 p/day (%)	Human Development Index Ranking ^a	Other U.S. Econ. Aid: FY2010 (millions) ^b
Armenia	Mar. 27, 2006	\$236 5 years	Sept. 29, 2006	-Agriculture/ irrigation -Rural roads	\$3,100	43.4%	76	\$41.4
Benin	Feb. 22, 2006	\$307 5 years	Oct. 6, 2006	-Land & property -Financial services -Judicial improvement -Port rehab	\$750	75.3%	134	\$35.5
Burkina Faso	July 14, 2008	\$481 5 years	July 31, 2009	- Rural land governance - Agriculture - Roads - Education	\$510	87.6%	161	\$6.0
Cape Verde	July 4, 2005	\$110 5 years	Oct. 17, 2005	-Agriculture -Transport/roads -Private sector	\$3,010	40.2	118	\$0.0
El Salvador	Nov. 29, 2006	\$461 5 years	Sept. 20, 2007	-Education -Transport/roads -Small business/farm development	\$3,370	20.5%	90	\$29.4
Georgia	Sept. 12, 2005	\$295 5 years	April 7, 2006	- Infrastructure/ gas - Transport/ roads - Agriculture/ business	\$2,530	34.2%	74	\$59.9
Ghana	August 1, 2006	\$547 5 years	Feb. 16, 2007	-Agriculture -Transport -Rural Development	\$700	63.3%	130	\$138.2
Honduras (completed)	June 13, 2005	\$215 5 years	Sept. 29, 2005	-Agriculture -Transport/roads	\$1,820	34.8%	106	\$49.5
Jordan	Oct. 25, 2010	\$275.1 5 years	—	-Clean Water and Sanitation	\$3,740	11.0%	82	\$363.0
Lesotho	July 23, 2007	\$362.6 5 years	Sept. 17, 2008	-Water sector -Health sector -Private sector	\$1,030	61.1%	141	\$28.1

Country	Compact Signed	Compact Size (millions)	Entry Into Force	Compact Focus	GNI per capita	Population Living Below \$2 p/day (%)	Human Development Index Ranking ^a	Other U.S. Econ. Aid: FY2010 (millions) ^b
Madagascar (terminated May 2009)	April 18, 2005	\$110 4 years	July 27, 2005	- Land titling/ Agriculture - Financial sector	\$420	88.7%	135	\$69.4
Malawi	April 7, 2011	\$350.7 5 years	—	-Electric power	\$280	91.0%	153	\$127.6
Mali	Nov. 13, 2006	\$460.8 5 years	Sept. 17, 2007	-Irrigation -Transport/ airport -Industrial park	\$680	82.0%	160	\$107.3
Moldova	Jan. 22, 2010	\$262 5 years	—	-Agriculture Roads	\$1,590	28.9%	99	\$19.0
Mongolia	Oct. 22, 2007	\$285 5 years	Sept. 17, 2008	-Transport/rail -Property Rights -Voc Ed -Health	\$1,630	38.8%	100	\$7.5
Morocco	August 31, 2007	\$697.5 5 years	Sept. 15, 2008	-Agriculture/ Fisheries -Artisan Crafts -Financial Serv/ Enterprise Support	\$2,790	24.3%	114	\$21.5
Mozambique	July 13, 2007	\$506.9 5 years	Sept. 22, 2008	-Water and Sanitation -Transport -Land Tenure/ Agriculture	\$440	92.9%	165	\$364.2
Namibia	July 28, 2008	\$305 5 years	Sept. 16, 2009	- Education - Tourism - Agriculture	\$4,290	62.2%	105	\$102.8
Nicaragua	July 14, 2005	\$175 5 years	May 26, 2006	- Land titling/ Agriculture - Transport roads	\$1,000	37.5%	115	\$34.1
Philippines	Sept. 23, 2010	\$434 5 years	—	-Revenue Reform Community Dev Rehab	\$1,790	43.8%	97	\$103.5
Senegal	Sept. 16, 2009	\$540 5 years	—	-Roads Irrigation	\$1,030	71.3%	144	\$105.1

Country	Compact Signed	Compact Size (millions)	Entry Into Force	Compact Focus	GNI per capita	Population Living Below \$2 p/day (%)	Human Development Index Ranking ^a	Other U.S. Econ. Aid: FY2010 (millions) ^b
Tanzania	Feb. 17, 2008	\$698 5 years	Sept. 15, 2008	-Transport/roads, airport -Energy -Water	\$500	91.3%	148	\$463.0
Vanuatu	March 2, 2006	\$66 5 years	April 28, 2006	-Transport rehab -Public Works Dept.	\$2,620	NA	Not ranked	\$0.0

Sources: Population Living Below \$2 Per Day—data from the World Bank, *World Development Indicators, 2010*; Gross National Income per capita (Atlas method)—2009 data from the World Bank, *World Development Indicators*. Human Development Index Rank—from UNDP, *Human Development Report, 2010*. MCC Information: MCC.

- a. The Human Development Index (HDI) is compiled by the U.N. Development Program and is published annually in the UNDP Human Development Report. It is a composite index that measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, as measured by life expectancy at birth; knowledge, as measured by the adult literacy rate and the combined gross enrolment ratio for primary, secondary, and tertiary schools; and a decent standard of living, as measured by GDP per capita in purchasing power parity (PPP) U.S. dollars. The most recent report (2010) evaluates 169 countries, with number 1 having the best HDI and number 169 scoring the worst in the Index.
- b. Other U.S. Economic Aid is defined here as Global Health and Child Survival, Development Assistance, Economic Support Fund, and Assistance to Europe, Eurasia, and Central Asia accounts.

Table 4. MCC Low-Income Candidate Countries—FY2011

Criteria: Per capita income \$1,905 and below, and not prohibited from receiving other U.S. economic assistance.

Compact Eligible Countries (FY2011) are in Bold

Compact Countries are followed with (C)

Threshold Eligible Countries (FY2011) are in Italics

Threshold Program Countries are followed with (TC)

Africa		East Asia/Pacific
Benin (C)	Tanzania (C)	Cambodia
Burkina Faso (C)	Togo	Kiribati
Burundi	Uganda (TC)	Indonesia (TC) (a lower-middle income country, but for eligibility and funding, treated as a low-income country until FY2012)
Cameroon	Zambia	Laos
Central African Rep		Mongolia (C)
Chad		Papua New Guinea
Comoros		Philippines (C)
Congo, Dem Rep of		Solomon Islands
Congo, Rep of		Vietnam
Djibouti		
Ethiopia		
Gambia		
Ghana (C)		
Guinea		Latin America
Guinea-Bissau		Bolivia
Kenya (TC)	South Asia	Guyana (TC)
Lesotho (C)	Afghanistan	Haiti
Liberia (TC)	Bangladesh	Honduras (C)
Malawi (C)	India	Nicaragua (C)
Mali (C)	Nepal	
Mauritania	Pakistan	
Mozambique (C)		Mid-East
Niger (TC)		Yemen
Nigeria		
Rwanda		
Sao Tome & Principe (TC)	Eurasia	Europe
Senegal (C)	Kyrgyz Rep. (TC)	—
Sierra Leone	Moldova (TC) (C)	
Somalia	Tajikistan	

Table 5. MCC Lower-Middle-Income Candidate Countries—FY2011

Criteria: Per capita income between \$1,906 and \$3,945, and not prohibited from receiving other U.S. economic assistance.

Compact Eligible Countries (FY2011) are in Bold

Compact Countries are followed with (C)

Threshold Eligible Countries (FY2011) are in Italics

Threshold Program Countries are followed with (TC)

[illegible]

Table 6. MCC Performance Indicators for FY2011

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

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