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Millennium Challenge Corporation:

Can the Experiment Survive?

John Hewko

The Millennium Challenge Corporation is the long-term, medium-risk component in the portfolio of foreign policy tools, and it should stay that way.

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Summary

The Millennium Challenge Corporation (MCC) was established in 2004 to provide grants to a select group of developing countries that demonstrate a commitment to good governance by investing in the health and education of their people and adopting sound economic policies. The MCC has performed admirably in the face of a number of challenges and unrealistic expectations, but its future success depends on its ability to address important philosophical and operational issues, and on Congress reforming the mechanisms by which it funds and judges foreign aid programs.

Congress must get serious about foreign assistance. It should significantly increase funding for long-term development programs that focus on economic growth, adopt a long-term perspective when evaluating such programs (and not judge them on the speed and quantity of disbursements), and embrace innovation and greater risk in the design and implementation of programs. With respect to the MCC, Congress should undertake the following measures: establish a commonly agreed vision for the agency; refrain from earmarking MCC funds or requiring that they be used to buy U.S. goods and services; permit MCC to take full advantage of its "no year" authority; remove the 25 percent funding restriction on low-middle income countries; permit MCC to sign up to four concurrent, full-term assistance agreements per country; increase the maximum permitted program duration from five to ten years; and maintain MCC's current independence.

Similarly, MCC should learn from past experience and missteps and maximize its impact by defining its governing principles clearly, and aggressively defending its view to Congress, the administration, and the development community. It should review and adjust its indicators for aid eligibility; adopt riskier and more innovative investment models; modify the mechanism by which it engages the private sector; simplify the approvals, reporting, and auditing requirements during program implementation; provide earlier, more robust training for country counterparts; and eliminate its threshold program (which is designed to improve indicator performance for countries that are close to meeting the MCC eligibility criteria) and reallocate these funds to health and education programs.

The Millennium Challenge Corporation (MCC) has just completed its sixth year of operations. This first phase was marked by controversies, criticism, and missteps, yet also by important progress and successes. The program is a noble experiment in development aid, but will fail to reach its full potential if Congress, the administration, and the new leadership at MCC do not resolve a number of fundamental issues critical to its long-term viability and success.

An Innovative Approach to Foreign Assistance

In early 2004, the Bush administration established the Millennium Challenge Account (MCA), a foreign assistance program that provides significant catalytic funding to developing countries whose policies and actions have put them on the path toward solid and sustainable economic growth. Its creation was in response to the mixed results of international development efforts over the past half century and to the growing body of evidence that aid works best in countries where the national leadership has initiated a meaningful economic and political reform process.

MCC is a U.S. government corporation, with a board of directors that includes four members from outside the government and is chaired by the secretary of state. Congress funds the MCA, and MCC administers its resources. Its operating model reflects five core principles:

- Sustainable prosperity and development require good governance, strong anti-corruption measures, sound economic policies, investments in health and education, and attention to issues such as gender equality and environmental protection.
- U.S. assistance will be most effectively utilized and have the greatest impact in those developing countries that implement policies that reflect such values.
- Recipient countries need to take ownership of the design and implementation of development programs to increase their chances of success.
- They need to be held accountable for the results of these programs and suffer the consequences of having aid reduced or curtailed if the programs do not succeed.
- Development assistance should fundamentally offer a strong incentive to countries to create the institutional, infrastructure, and regulatory conditions that spur economic growth and enable the private sector to flourish, thereby significantly diminishing over time the need for that assistance.

Eligibility for MCC funding is based on seventeen indicators that measure a country's relative performance against its peers in the areas of good governance; investments in health, education, and the environment; and economic policies. These indicators are maintained by independent entities outside the U.S. government. Each year the MCC board of directors reviews indicator performance and underlying policy actions. The agency can suspend or terminate assistance if the board finds an eligible country has made significant declines, systematically pursued poor policies, or failed to implement successfully an ongoing program.

Countries that are ruled eligible for MCC funding then analyze their constraints to growth; consult with their civil society and private sector to identify priority areas for MCC funding; design their MCC programs; and, when funding is provided, implement these programs. Each recipient country establishes an MCA entity, which implements the program and serves as the conduit for funding. Generally, a board comprising representatives from government, civil society, and the private sector governs these MCA entities. MCC assistance is provided in the form of untied grants, not loans that must be repaid, and recipient countries are not required to use the funding to procure U.S. goods and services.

When reviewing a country's proposed program, MCC considers whether it is sustainable; will reduce poverty and generate significant economic rates of return; can be completed within five years; is consistent with other donor programs and the country's national development strategy; and can be evaluated against agreed output and outcome benchmarks. Once MCC approves a country's program, it agrees to fund it for the full period of the program and then disburses monies as implementation milestones are met. This eliminates the need to ask Congress for annual appropriations for that program and allows the country to be more effective in managing its long-term development budget. The MCC website, www.mcc.gov, publishes countries' annual indicator results and all MCC assistance agreements, which are called compacts. The site offers detailed information about the benchmarks for measuring program effectiveness, programs' expected economic rates of return, and a detailed beneficiary analysis.

MCC also maintains a "threshold program" under which countries that are close to meeting the eligibility criteria receive more modest funding for programs designed to improve indicator performance so the country might become eligible for an MCC compact. The U.S. Agency for International Development (USAID) administers this program on MCC's behalf.

MCC has entered into compacts with 20 of the 24 eligible countries, committing more than $7.2 billion to long-term sustainable development; the majority of funding has gone to infrastructure and agricultural development projects. The threshold program has made $470 million available to nineteen countries. The agency's total permanent staff is approximately 300 people; offices in compact countries rarely employ more than five people. MCC's annual budget appropriations have ranged from $875 million to $1.7 billion.

While many of the individual ideas and concepts that were applied to MCC are not new, the attempt to repackage them into an alternative approach by focusing on good governance and policy performance as the critical element in obtaining MCC eligibility and funding, "depoliticizing" the eligibility process through the use of indicators maintained by independent third parties, creating competition among developing countries for MCC funding, focusing almost exclusively on poverty reduction through economic growth as the criteria for evaluating funding decisions, relying on recipient countries for program design and implementation (including the carrying out of program procurements), providing assistance in the form of significant untied grants and not loans, funding multi-year programs up front, holding recipient countries accountable for measurable results, and operating with a high degree of transparency is unique. Whether the experiment is ultimately successful will depend, in large measure, on the extent to which Congress and present and future administrations are willing to change radically the ways in which foreign assistance programs are created, funded, and judged.

Time for Congress to Take a New Stand on Development Aid

The view among many Americans is that the United States allocates significant funds to foreign assistance. In a 2002 survey by the Chicago Council on Global Affairs, respondents, on average, estimated that 31 percent of the federal budget is spent on foreign aid. The reality is very different. Although the U.S. government spends more than any other country on foreign aid in absolute terms, in 2008 this amount represented only 0.81 percent of the annual U.S. budget and 0.19 percent of gross national income (GNI). Members of the Organisation for Economic Co-operation and Development's (OECD) Development Assistance Committee (DAC) average 0.31 percent, and EU nations average 0.43 percent of GNI. In addition, if one examines the U.S. foreign assistance budget, only a small portion is allocated to "pure" development efforts designed to have long-term sustainable impact. Much of what is called "foreign aid" is intentionally political, expressly directed at national security goals, or used for short-term humanitarian efforts. Although many of these expenditures and their goals are legitimate and needed, including them in a discussion of foreign aid makes the relatively low amount the United States spends on long-term development seem far larger.[1]

There is also a belief among some that foreign assistance resources are often wasted and spent on corrupt regimes and white elephant projects that bring little benefit to the world's poor. This position was perhaps most aggressively articulated by the late senator Jesse Helms, who claimed that foreign aid "is the greatest racket of all time" and "a ripoff of the American taxpayer" that "lines the pockets of corrupt dictators, while funding the salaries of a growing, bloated bureaucracy."

To be fair, there has been waste in programs, and corrupt regimes have received assistance funds allocated for expressly political or strategic purposes. Foreign assistance has also not been the magical elixir that permits the developed world to buy growth and prosperity for the less-developed nations. Yet it is far from a failure. Consider the success of the Marshall Plan, which transformed Europe after World War II, or how U.S. support (through the Rockefeller and Ford foundations) helped launch agriculture's Green Revolution in the 1950s. U.S. assistance helped turn Korea from a country with one of the world's lowest GDP-per-capita ratios to one that is on par with the OECD (and now a donor itself). U.S. assistance has helped to improve dramatically health and education indicators, and infant mortality rates have plummeted around the world. But in the perception of some, these successes are outweighed by too few examples of sustainable results and too many examples of less-than-worthy aid recipients and call into question the utility of funding foreign aid.

Despite the widely acknowledged shortfalls of the current structure, foreign aid programs—if properly targeted, designed, and managed—can be tremendous investments for the United States and extremely beneficial for its long-term strategic international objectives. In addition to any arguments based on moral obligations and imperatives, promoting economic development, providing humanitarian assistance, encouraging good governance and the fight against corruption, financing infrastructure projects, and supporting health and education in the right impoverished countries enhances U.S. security, promotes goodwill, and advances our global interests at a fraction of the cost of defense and other "hard" foreign policy tools. The marginal returns on the last $10 billion of the defense budget are generally minuscule when compared with the returns those funds would generate if they were re-allocated to well-developed foreign assistance programs.

Furthermore, programs such as MCC reflect core American values that, if properly explained and marketed, would resonate with most Americans. Funding is not a "giveaway," but a benefit that a country earns through hard work and good policy performance. Recipient countries identify problems and solutions locally rather than accepting programs that are often viewed as highly politicized and motivated by objectives other than long-term development. Funding is subject to strict performance criteria with meaningful consequences for doing a poor job. Yet Congress, despite an increasing public perception of significant waste in the defense budget, routinely and reflexively increases defense spending by the tens of billions, while nickel-and-diming U.S. foreign assistance agencies that are forced to come begging and groveling for micromanaged funding.

The lack of a broad-based domestic constituency means that the push for foreign assistance will have to originate with Congress. The time has come for Congress to take a stand: it either believes in the utility of well crafted and funded soft power or it does not. The current situation of keeping development programs muddling along on life support represents, if perhaps not a waste, certainly a lost opportunity to advance U.S. security and diplomatic interests in a relatively inexpensive and cost-effective manner.

The Need to Embrace Innovation, Risk, and a Long-Term Perspective

In private sector investment, a prudent portfolio includes a mix of asset classes—cash, stocks, bonds, and perhaps commodities—with differing levels of risk and time horizons. Similarly, the portfolio of U.S. "soft power" should include a range of foreign aid programs tailored to address the broad array of challenges that developing countries face and to achieve a range of U.S. security and strategic goals.

Many challenges, such as the need for humanitarian assistance and disaster relief, should be addressed through programs and institutions that can respond rapidly and generate immediate short-term benefits but few long-term, sustainable returns. Others require a medium- or long-term approach or need to be directed to non-development purposes that are influenced primarily by security and strategic considerations. Short-term interventions and those that are directed solely at national security considerations make the headlines and provide a temporary sense of doing something or defending the homeland. But lasting and meaningful change stems from long-term investments in economic growth and its underpinnings: good governance and sound economic and regulatory policies.

Unfortunately, the Congressional yearly appropriations cycle and its relentless focus on yearly disbursement figures and immediate results make it difficult, if not impossible, to design and implement successfully a program with a lengthy time horizon. Although Congress cannot be expected to write a blank check, if the United States is interested in a truly meaningful and effective portfolio of assistance programs, Congress and current and future administrations must embrace the idea that a significant portion of the portfolio include long-term investments that do not immediately bear their most important fruit or show immediate concrete results. This, in turn, would require that Congress manage and exercise oversight authority with respect to such programs in a way that is fundamentally at odds with how it currently operates—no earmarks, no micromanaging of programs by interventionist Congressional staffers, no demands for instant success and short-term "deliverables," no excessive oversight burdens, and no politicization of programs and the allocation of funds.

A similar failing exists with respect to the concept of risk. A balanced investment portfolio requires a blend of investments that are subject to varying levels of risk. A foreign assistance portfolio should be no different and needs to contain projects and delivery mechanisms that could fail, but have the potential, if successful, to have meaningful and long-term impact. In addition, eliminating the fear of failure—the enemy of any risky investment—would foster innovation among countries and donor agencies in designing and implementing specific interventions. Yet often the program that produces little impact but disburses funds quickly and complies fully with all policies and procedures is hailed as a success, whereas one with meaningful results but less than perfect procurements and small leakages of funds is condemned for "wasting" taxpayer money.

This mindset is reinforced when largely symbolic and relatively minor issues of implementation become the focus of inspectors general or congressional oversight, whether through hearings or Government Accountability Office (GAO) investigations. Why were so many vehicles purchased? Why does a recipient country fail to maintain a robust policy on the use of cell phones purchased in connection with the program? Why were arcane, U.S.-based policies and procedures (that are often unworkable in the local context) not followed? However, this type of review too often misses the important questions: Has a program made a significant and sustainable impact on poverty? Have we contributed to the development of better-governed and politically stable countries? Have we advanced long-term U.S. diplomatic and strategic interests? These are difficult questions and, if there are meaningful answers to be found, they are often years in the making—a process too slow for Congress (and often the administration), which must face annual appropriations and perpetual election cycles. Yet real success and impact—rather than the facile pat on the back for having met an annual disbursement target and filled out forms with mechanistic precision—requires accepting a certain level of risk and failure and supporting a long-term approach that focuses on the forest rather than the trees.

Finally, there needs to be a greater willingness to support projects that do not necessarily resemble traditional assistance interventions. MCC projects in Madagascar to reform the country's process for managing and issuing sovereign debt and to modernize its national interbank payments system, and in Georgia to establish an independently managed investment fund that would make equity investments in promising small- and medium-sized enterprises were roundly criticized by some in Congress for failing to offer immediate assistance and direct poverty alleviation. However, these are exactly the sorts of investments that create the foundation for private-sector development and sustainable mechanisms for reducing poverty.

How Doing Business the "Washington Way" Could Destroy MCC's Promising, Long-Term Approach to Development

MCC plays a narrow, but very important, role in the U.S. foreign-assistance framework as a long-term approach to reducing poverty through sustainable economic growth. However, its potential is slowly eroding. This is partly a result of decisions made by MCC's senior management (including the author) during the program's first five years. More detrimental is the nature of doing business in Washington, which hinders MCC's chances for success.

In order to understand where MCC is and where it should head, it is important to highlight some of the initial challenges that the agency faced and, with the benefit of hindsight, some of its early missteps in addressing them.

Unrealistic Expectations and Assumptions

Congress established MCC in January 2004, and the program received an initial appropriation of almost $1 billion. In May 2004, the MCC board of directors approved sixteen initial countries as eligible for MCC funding. At that time, there were fewer than 25 employees in the entire agency; several hundred more needed to be hired. Few policies were in place, and the department that had the lead in developing and negotiating compacts had only four employees.

However, to the outside world, MCC was not an early stage start-up, valiantly struggling to hire staff and develop its operating procedures; it was an agency with a great deal of money, an ambitious mandate, and stakeholders (including Congress) with little patience for excuses and even less appreciation for the agency's challenges. The first MCC employees were building an agency from scratch, yet were being asked to operate from Day One as a fully staffed, functioning institution.

This difficult situation was exacerbated by differing expectations—in Congress, the White House, other agencies, recipient countries, the development community, and even within the MCC—about the agency's nature and its operating model. MCC was urged by many to be bold and to take risks, but its efforts were scrutinized to ensure that every penny could be traced and that the highest technical, procurement, cash management, and environmental standards were followed. Some wanted MCC to work with governments and fund programs that were large and transformative, yet they failed to appreciate that MCC partner countries had limited human resources and often-weak absorptive capacity. Other stakeholders envisioned a process that provided smaller grants directly to local nongovernmental organizations and grass-roots groups while maintaining absolute fiscal control, ensuring good measurement of results and being "transformative."

The agency was asked by some to take a long-term view, "get it right," focus on country ownership, and expose its partner countries to a new way of designing and implementing programs (which MCC itself was still developing), yet was judged almost exclusively on how quickly compacts were signed and money was disbursed. Congress provided "no-year" money, then turned around and roundly criticized the agency for carrying unobligated balances to the next fiscal year. MCC's ability to obligate and disburse funds more quickly was hampered by the statutory requirement that it could enter into only one compact at a time with any given country. Most country proposals contained projects that were in varying stages of preparation, so MCC was forced to wait until all components were sufficiently designed and developed before approving a compact. This delayed implementation and disbursement and further reinforced the view that MCC was slow in getting things done.

Were initial expectations of the agency unrealistic? Yes. But it is also true that some of the underlying assumptions on which MCC was founded had problems. The notion that MCC could transform a country with one or more large compacts was not realistic. The related goal of responsibly spending as much as $5 billion per year was overly ambitious, particularly given the limited number of countries that could meet MCC's eligibility standards, the lean agency staffing levels (the original plans called for no more than 100 employees), and the agency's "project finance" operating model that required considerable time to review and refine country program proposals. Finally, the recipient countries' constrained capacity and the need to meet strict congressional oversight and accounting standards undermined any thought that the MCC would be merely "cutting checks" to relatively high-performing countries. These assumptions created unrealistic expectations that the agency and its newly hired staff had to confront and manage.

Initial Missteps

MCC contributed to its early problems by miscalculating on several crucial matters. First, the MCC board erred in choosing sixteen initial eligible countries—more than its several dozen employees could reasonably handle. In the first few months after the initial country selection, there were periods of several weeks when almost the entire agency—all but four employees—was visiting eligible countries. The burdens on the staff were further increased by bureaucratic requirements and unreasonable congressional pressure. In June 2004, before MCC could complete initial visits to the compact-eligible countries, voices from the Hill were asking why no compacts had been signed. Shortly thereafter, a constant deluge of inspector general, GAO, and other oversight activities began. This forced the MCC's senior management, already stretched thin, to spend considerable time dealing with oversight and bureaucratic matters rather than working to deliver badly needed assistance to the world's poor.

Second, MCC failed to move more aggressively and efficiently to hire new staff. This prevented the agency from focusing on all of the eligible countries and forced it to allocate its scarce resources to the five countries that were the furthest along in the compact development process. This left the other eleven free to complain to the Hill and the White House about the lack of attention from MCC.

Third, MCC initially interpreted the concept of country ownership very strictly by giving the countries significant scope to carry out the consultative process and design initial program proposals. This was motivated by several factors. There was a view that countries that passed the initial screening should have the capacity to produce well developed proposals on their own.

There was a fear that they would reflexively turn to USAID and other donors to prepare investment proposals for them, thereby undermining the empowerment that was one of the core pillars of the MCC process. The need to encourage eligible countries to develop their own proposals also stemmed from the sheer number of countries involved; MCC's small staff could provide only so much "hands-on" support to sixteen countries. Unfortunately, local capacity constraints and recipient countries' deeply ingrained expectations that they be told what to do resulted in initial frustration as the countries struggled with this new approach and led to program proposals that were of poor quality and needed significant revision.

Fourth, MCC spent too much time trying to make proposals work rather than quickly rejecting components that were unlikely to meet the funding criteria. The agency decided to respect country ownership at all costs; unfortunately, this resulted in lost time and delayed the compact development process.

Finally, MCC did a poor job of managing its relations with Congress and outside stakeholders. In the face of multiple competing and irreconcilable pressures and expectations, MCC went on the defensive, trying to be all things to all people rather than clearly articulating what the agency was and aggressively defending that vision—even if it meant drawing further criticism.

A Success Nevertheless

MCC has constantly faced unrealistic expectations and a rolling wave of criticism. The pace of compact signings drew fire first; then came criticism of the program's focus (too much hard infrastructure such as roads, too little health and education), its rate of disbursements, and now its failure to demonstrate transformative results. Yet when the bureaucratic machinations of Washington are removed from the equation, MCC has been a success.

The country selection process—the use of transparent, independent, third-party indicators—has created a competition among countries to become MCC-eligible and has encouraged them to adopt meaningful policy and regulatory reforms. In Lesotho the prospect of MCC funding led the government to adopt historic legislation granting women the right to own property and enter into binding contracts. The World Bank reported that the MCC eligibility process created a strong incentive for El Salvador to reduce dramatically the time it takes to start a business, from 115 days to 26 days. In 2007 Bangladesh, a country that was neither compact eligible nor chosen for a threshold program, submitted a detailed action plan to MCC designed to help improve its scores on a number of MCC indicators.

Reformers, civil society groups, and journalists have used the process to exert meaningful pressure on their governments and politicians. Governments have been forced to initiate and maintain a more robust dialogue with civil society to meet the MCC requirements of broad consultation. Nongovernmental organizations and private-sector representatives are being brought in to the compact implementation and oversight process. This has led to compact programs that enjoy widespread political support, even in countries where governments that were responsible for negotiating and signing compacts were succeeded by leaders with radically different economic or social agendas.

Country design and implementation has led to a clear sense of ownership, an increase in enthusiasm and pride, and a considerable transfer of skills and know-how in economic analysis, program design, environmental and social analysis, gender sensitivity, financial accountability, procurement, and monitoring and evaluation. The MCC process has generated significant goodwill in developing countries and contributed to U.S. foreign policy objectives in those where it operates.

MCC has undertaken an unprecedented level of transparency and implemented a robust process of impact evaluation that will identify the successes and shortcomings of its model and offer valuable lessons to the development community. During the past year MCC has backed up theory with action: it has withheld, suspended, or terminated assistance to Nicaragua, Armenia, Honduras, Madagascar, and Niger for failing to adhere to the MCC eligibility criteria.

Individual compacts are meeting agreed interim output benchmarks. In El Salvador, the new left-leaning FMLN administration has praised the compact and the MCC process for its transparency and positive impact on the country's development. The compact's productive development project focuses on technical assistance, training, and financial services to farmers and micro, small, and medium businesses and has exceeded its beneficiary targets by almost 35 percent. Management of compact funds has been successfully transitioned from an outside fiscal and procurement agent to FOMILENIO, the Salvadoran MCA entity, and over 1,000 procurement actions have been completed with only one protest filed. The Northern Transnational Highway—which will connect the poorest regions of the country to social services and to national and international markets—is under construction and should be completed within the five-year compact period. FOMILENIO recently signed a $33 million public-private partnership agreement with AES Corporation to connect approximately 30,000 rural households to the electric grid.

In Cape Verde, 40.5 km of three rural roads that connect coastal and inland villages with larger population centers and markets have been upgraded from cobblestone to asphalt pavement. Four bridges have been built and much of the initial work on the country's principal port has been completed. In light of the country's successful implementation of its first compact, the MCC board of directors recently selected Cape Verde as eligible to submit a proposal for a second compact.

Going Forward

For MCC to reach its full potential, the lessons of the past must be understood and applied to the future. Otherwise, a valuable component in the U.S. development portfolio will be underutilized. The following changes are crucial to maximizing MCC's impact and the returns on its activities to the United States and MCC partner countries.

MCC must accomplish these seven tasks:

1. **Define its governing principles clearly.** MCC should define clearly and concisely what it stands for, then aggressively defend that view to Congress, the administration, and the development community. Elements of this would include:
   - MCC is a long-term investment vehicle that is expected to have a meaningful impact on poverty reduction and growth. That can take seven to ten years from initial engagement with an eligible country.
   - MCC's long-term programs and commitments make it an inappropriate "tactical" tool for current and near-term foreign policy goals. MCC should not be used for short-term goals such as providing "deliverables" for summits, rewarding countries for supporting the United States on specific geopolitical issues, or pressuring countries in ongoing trade negotiations or commercial disputes with U.S. companies.
   - Even though MCC countries are performing relatively better than their peers, as evidenced through their performance on the MCC selection indicators, the program's limited resources and the sheer number and scope of development issues that need to be addressed should temper expectations as to the scale and scope of success to be expected from MCC compacts. To the extent that MCC aspires to be "transformational," that goal should be limited to sectors or regions rather than economies as a whole.
   - MCC will take its time to get it right, even if that means delaying the signing of compacts and disbursing of funds. Many of the country proposals have contained complicated infrastructure projects that take time to develop. Although MCC has been criticized for being slow, it has concluded and implemented compacts with these types of projects much more quickly than is often the case with other donors or the private sector. One need only look at the time it takes to design, finance, and build large infrastructure projects in the United States to appreciate the challenges faced by a small and land-locked country where a large percentage of citizens live on less than $2 per day.
   - Infrastructure and rural development are essential to long-term growth and poverty reduction. Other donors have paid little attention

to these needs over the past decade, so it is not surprising that MCC-eligible countries have asked for significant funding for projects such as roads, water, and sanitation. MCC will continue to respect country ownership and, if requested by its partner countries, continue to invest in these areas—even at the risk of criticism from Congress and other stakeholders that compacts contain too little funding for health and education programs.

- MCC should continue to be given the freedom to withhold, suspend, or terminate assistance to compact countries that fail to meet MCC indicator standards or to implement a compact properly, even if this has a negative effect on other short-term foreign policy objectives.
- Success should not be measured by the pace at which compacts are negotiated and signed, nor by the speed or quantity of disbursements.
- Initial success should be evidenced by:
    - A spirited competition among countries to perform well on the MCC indicators and become compact-eligible.
    - An empirical confirmation that the MCC indicator methodology is encouraging countries to undertake and maintain serious governance, policy, and regulatory reforms.
    - Robust consultative processes that improve the dynamic between the government, civil society, and the private sector.
    - Eligible countries entering into high-quality compacts and gaining experience in economic analysis and program design.
- Intermediate success should be evidenced by:
    - The creation and staffing of a competent domestic implementing entity that minimizes the impact on existing government institutions.
    - A measurable enhancement of country capacity in financial accountability, environmental and social analysis and mitigation, procurement, and monitoring and evaluation of results.
    - Interim output targets being met as agreed in the compact.
- Long-term success should be evidenced by outcome targets relating to poverty reduction and growth being met and the policy environment continuing to improve.
- A limited number of the programs will fail, experience significant delays, or exceed the five-year compact term. This is to be expected and accepted, given the realities and risks of investing in long-term development. Although MCC is being praised for a level of transparency that exceeds that of other bilateral and multilateral donors,

this will lead to increased awareness of the inevitable failures. MCC must be permitted to survive this candor and not be punished for its transparency.

- During implementation, MCC compacts will need to be amended and refined, and funding may be de-obligated or shifted among projects. This is not a failure but an expected result.

2. **Review and adjust the eligibility indicators.** These indicators are an essential component of the agency's operating model and will determine its future success. They provide a transparent, apolitical, and objective mechanism for establishing eligibility and create an incentive for countries to undertake reforms and adopt sound policies. However, they face a number of inherent problems:

   - They are relative, employing a floating median. A country can meet the eligibility criteria in one year yet fail in the next, even if there has been no change in its absolute performance or any significant policy reversal.
   - Data lag on many of the indicators means indicator performance in a given year often reflects policies undertaken one or two years earlier. If there has been a change in government during that period, the results might punish or reward the wrong leaders.
   - The indicators exhibit an income bias, because wealthier countries can afford to spend more on health, education, and the environment. Although some of this bias was addressed by creating a low-income category (LIC) and a low-middle income category (LMIC), there is sufficient income disparity within a category that the wealthiest LIC or LMIC countries have a significant advantage over their poorest peers.
   - The strict application of indicator results becomes difficult to manage when a country graduates from LIC to LMIC status after its initial selection, but before it is able to sign a compact. When this happens, the country might no longer meet eligibility requirements and would be subject to the funding restrictions imposed on LMICs.
   - Measuring results as pass/fail is simplistic; the indicators are complex. These problems undermine the perception that continued MCC eligibility is "objective" and make it difficult to implement a consistent and fair policy of choosing eligible countries and withholding, suspending, or terminating assistance where indicators signal poor performance.

MCC's new CEO, Daniel Yohannes, is committed to a thorough review of the indicators, and this is welcome news. Developing indicators is difficult since they must be annual yet timely; consider the priorities and preferences of the many MCC stakeholders; and cover a pool of nearly 90 candidate countries. Any meaningful review will require that all of the interested parties acknowledge these difficulties and offer realistic suggestions for improvement rather than reflexive defense of favorite indicators. Once the new rules created in this review have been adopted, they should be applied rigorously and without exception to maintain the incentive effect and strengthen country accountability for results.

3. **Utilize more innovative and riskier investment vehicles and models.** MCC has operated under the "project finance" model of designing, funding, and evaluating specific programs and projects. While this approach permits greater financial oversight and control and a greater ability to link results to specific spending, it could weaken government capacity and undermine government institutions by creating independent MCA entities that often hire the most competent civil servants. The project finance model demands significant time and energy in program design and due diligence and, if carried out properly and thoughtfully, can prompt criticism that MCC moves too slowly. MCC should consider alternative mechanisms, such as the creation of guarantee funds for private sector investment in energy, transportation, and other infrastructure projects or sector-targeted budget support that would be made available against the meeting of performance targets, even if this results in an increased risk of fiscal and procurement leakage and decreased abilities to link specific dollars to specific outputs, ensure that environmental standards are met, or monitor and evaluate performance.

4. **Modify the mechanism for engaging the private sector.** MCC has often indicated that the private sector is its exit strategy. Its operating model is based on the premise that the compact programs will help create the conditions for increased economic growth and result in subsequent private sector investment that would not have occurred without MCC intervention. Since most of the compacts remain to be completed, it is too early to determine the extent to which such additional investment has occurred.

   However, it is clear that MCC has yet to develop a mechanism for attracting significant *upfront* investment from the private-sector, particularly with respect to large infrastructure projects. To do so, MCC should reconsider the formal role that the private sector plays in the compact development process.

   Under the current model, MCC funds are offered as a reward to countries for good governance and policy performance. Once a country is chosen, its government takes the lead in conducting a broad consultative process with the private sector and civil society and in designing the country's investment proposal to MCC. However, this mandatory consultative process focuses on general constraints to growth and broad areas of potential intervention and is often too diffuse to identify opportunities with specific private sector entities that will lead to significant upfront leveraging of MCC resources.

After the initial broader consultative process has identified the general priority areas for investment, MCC should require the country to convene a second consultative process that is limited to international and domestic private sector entities. This process would attempt to identify specific private sector companies interested in making upfront investments in these priority areas (however, there should be no preference given to U.S. companies as this would undermine one of the core MCC principles). For example, a multinational could agree to finance and construct a power plant if MCC agreed to fund the construction of the public goods (roads, transmission lines, and so on) needed to make the facility economically feasible. In such a case, MCC could consider signing a compact directly with the private sector entity, as is expressly allowed under MCC's authorizing legislation. It could also consider using MCC monies to support sovereign guarantee funds that would enable infrastructure projects, particularly in the power sector, to be developed and implemented by the private sector.

These alternative approaches might meet resistance on a number of fronts. Signing a compact with one private sector entity could give rise to allegations of favoritism or lack of transparency. Congress or the NGO community might object because these approaches do not provide immediate (and camera-friendly) benefits to the poor. However, these are precisely the sorts of interventions that are needed if one is interested in creating sustainable growth and using MCC resources to mobilize the vast pool of funding available in the private sector.

5. **Simplify the approvals, reporting, and auditing requirements during implementation.** MCC's initial approach was to require the MCA entities to obtain approval from MCC's Washington office for a broad range of decisions. This was driven in large measure by the strict oversight standards demanded by Congress, the GAO, and MCC's inspector general, and the belief that it would be easier to devolve authority to the MCA entities than to take it away. However, based on anecdotal evidence from the field and the drumbeat of complaints by the countries, it is clear that MCC's approval and reporting processes are too onerous (and in many cases much more stringent than those of the multilateral institutions). These burdens slow compact implementation and aggravate the host country. The list of MCC-required approvals should be significantly curtailed and the number and complexity of country reports dramatically reduced. MCC should require annual, rather than quarterly, country reporting and consider ex-post audits in those countries with relatively robust financial oversight systems. This, however, would require Congress and the administration to accept a greater degree of risk and failure and some leakage of funds. As a quid pro quo for greater country control and less MCC oversight, MCC should institute a "one-strike" rule and cut off funding for any country that abuses this greater trust and responsibility or fails to meet the program benchmarks.

6. **Provide earlier, more robust training for country counterparts.** The initial MCC operating model underestimated the lack of country capacity and the difficulty in receiving "shovel-ready" investment proposals from recipient countries. MCC should continue to use its Section 609(g) authority to offer country counterparts significant training in program design, procurement, and financial management. This training must preserve country ownership and ensure that the compact reflects the country's priorities as identified through a robust consultative process. This training would take place very early in the compact development process, before establishing a final procurement and fiscal accountability process, so MCC would need to be permitted to disburse these 609(g) grants through country systems, even at the risk of some leakage and less-than-perfect procurements.

7. **Eliminate the threshold program and use the funds for health and education.** Responsibility for helping countries become MCC-eligible should be turned over to USAID, which currently manages and implements almost all aspects of the threshold program. MCC's small threshold staff is not equipped to provide meaningful or substantive input to threshold program design or implementation and the agency's role is essentially to funnel funding to USAID. This largely bureaucratic activity siphons MCC staff efforts from the agency's principal goal: working with eligible countries. MCC's interaction with candidate countries should be limited to assisting them in understanding the selection indicators and the eligibility process. Threshold funds should instead be used to fund immediate grants to newly selected countries for interventions in health or education. This change would require that MCC have the authority to enter into concurrent compacts and could work as follows:

    - MCC would carry out a robust vetting process and pre-qualify one or two NGOs to act as implementing partners in education and health.
    - When a country is ruled MCC-eligible, it would begin the standard compact development process, but would also automatically receive a grant of $25 million to $50 million (depending on population) under a "pre-compact."
    - The country would chose whether it wanted this grant to be used for health or education programs and would indicate its preferred implementing partner. The country and its partner would then have six months to develop and design a program in the chosen area.
    - MCC would employ a streamlined process to approve the program and would disburse funding directly to the implementing partner. The partner and country would be jointly responsible for program implementation and success. The process would be strengthened if the program implementation partner committed to matching a portion of MCC funding.

This approach would be fully consistent with the MCC principle of country ownership since the country could decline this pre-compact grant. It would also strengthen the compact process and create momentum and capacity for handling the larger compact program. These pre-compacts would placate stakeholders and congressional staffers who criticize MCC for not funding enough health and education programs. It would result in a significant disbursement within six months of a country being selected for MCC funding, addressing concerns that MCC is slow to disburse. And it would provide the political leadership of a newly eligible country with an immediate "deliverable" and reward for good policy performance. This, in turn, would lessen the often-relentless pressure for MCC to sign compacts quickly and permit a more comprehensive and robust development process for the main compact, which most countries have used for complicated infrastructure projects that take time to design and implement.

Congress and the administration must accomplish these seven tasks:

1. **Agree on the vision.** Congress and the administration should work with MCC to articulate a common vision for the agency, then stick to that vision.

2. **Forbid earmarks.** Country ownership is crucial to MCC's effectiveness. Earmarking MCC funding or dictating how compact funds may be spent should be soundly rebuffed. This meddling would destroy the MCC model and guarantee the agency's failure.

3. **Forbid a "Buy-American" requirement.** This might upset U.S. contractors that rely heavily on government business, but it results in the recipient countries receiving the best product for the lowest cost. It also strengthens local companies by permitting them to compete on equal footing with U.S. and other foreign vendors.

4. **Permit no-year money.** Congress should continue to permit MCC to take full advantage of its "no year" authority. The MCC eligibility and compact development process is demanding, requires eligible countries to expend significant political capital and energy, and often takes two or more fiscal years to complete. Many countries will be hesitant to embark on the process and create the inevitable public expectations if there is no reasonable certainty that funding will be available. The program must continue to have the ability to carry unobligated balances from fiscal year to year. Given the complexity of many of the investment proposals, it is very difficult for MCC staff to indicate to Congress the precise amount of each future compact and the timing for signature. MCC cannot invest effectively when it is spending time attempting to predict with extreme accuracy its budget needs and struggling to eliminate unobligated balances in the face of congressional criticism.

5. **Remove the 25 percent LMIC funding restriction.** MCC's authorizing legislation, to the extent it is clear, essentially prohibits MCC from allocating more than 25 percent of its appropriated funds to LMICs. This was intended to ensure that the bulk of MCC funding goes to the poorest countries. The LMIC/LIC distinction is appropriate for purposes of determining MCC eligibility, but the funding restriction should be abolished. Even LMICs have significant pockets of extreme poverty; consider Indonesia, which is an LMIC with more than 100 million people living on less than $2 a day. The restriction significantly hampers MCC's ability to manage its budget and the schedule for compact signings, and it aggravates countries whose compacts are delayed as MCC valiantly attempts to ensure that sufficient funding is available to conclude the LMIC compacts.

6. **Permit concurrent and longer compacts.** MCC may not enter into more than one compact at a time with a given country, but most country proposals contain programs and projects that are in different stages of development. The inability to sign more than one compact requires MCC to sign small, single-component compacts or wait until all of the projects are ready for signature. This impedes MCC's ability to start programs and disburse funds. Congress should permit as many as four concurrent, full-term compacts per country. This would allow MCC to sign compacts quickly with more developed projects while taking longer to finalize those that need additional work.

   Current legislation also limits compact duration to five years, but many projects (especially infrastructure) are very difficult to complete in five years. The limit should be increased to ten years.

7. **Maintain MCC's independence.** The U.S. foreign aid structure needs reform. The Presidential Study Directive (PSD-7) to review and provide strategic direction on U.S. global development policy, the State Department Quadrennial Diplomacy and Development Review, and House Foreign Affairs Committee Chairman Howard Berman's effort to rewrite the Foreign Assistance Act are considering the nature of that reform. MCC's success stems from its relative insulation from the short-term political pressures of the State Department and other agencies. Merging MCC into USAID or the State Department would be fatal to the MCC mission. Its current structure as a U.S. government corporation with a board chaired by the secretary of state strikes the appropriate balance of allowing MCC to pursue long-term investments while ensuring its activities are consistent with U.S. foreign policy objectives. MCC is the long-term, medium-risk component in the portfolio of foreign policy tools, and it should stay that way.

Note

1 In fairness, there are those who argue that if the substantial private donations from U.S. citizens and charities and the amounts spent by the United States to support international peacekeeping were included in the calculations, the United States would appear to be much more generous than its percentage of GNI figure would indicate. Nevertheless, U.S. official development assistance represents a very small portion of the annual budget and is relatively small on a percentage of GNI basis when compared with what other developed countries provide.

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