



# Millennium Challenge Corporation

**Curt Tarnoff**

Specialist in Foreign Affairs

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## Summary

The Millennium Challenge Corporation (MCC) provides economic assistance through a competitive selection process to developing nations that demonstrate positive performance 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 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; and
- an emphasis on public transparency in every aspect of agency operations.

On February 13, 2012, the Administration issued its FY2013 State, Foreign Operations budget, requesting \$898.2 million for the MCC, the same amount it received in FY2012 and FY2011. In September 2012, the Continuing Appropriations Resolution, 2013 (H.J.Res. 117, P.L. 112-175), was approved by Congress, providing FY2013 funding for the MCC at the level in the FY2012 Consolidated Appropriations Act (P.L. 112-74) plus 0.612%—\$904 million. The resolution expires on March 27, 2013.

Congress authorized the MCC in P.L. 108-199 (January 23, 2004). Since that time, the MCC's Board of Directors has approved 26 grant agreements, known as compacts: with Madagascar (calendar year 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), Malawi (2011), Indonesia (2011), Cape Verde II (2011), and Zambia (2012).

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 March 1, 2013, if sequestration requirements under the Budget Control Act of 2011 (P.L. 112-25) go into effect, the MCC FY2013 budget will likely be cut. Reduction estimates vary, but the latest Congressional Budget Office estimate suggests a cut of 5.3% to non-defense accounts.

On December 19, 2012, the MCC Board announced countries eligible for new compacts—Liberia, Niger, Sierra Leone. Morocco and Tanzania were made eligible for second compacts. Guatemala was selected for a threshold program. Benin, El Salvador, Georgia, and Ghana are allowed to continue developing their compact proposals, and Honduras and Nepal can continue developing their threshold programs.

In September 2012, the Continuing Appropriations Resolution, 2013 (H.J.Res. 117, P.L. 112-175), was approved by Congress, providing FY2013 funding for the MCC at the level in the FY2012 Consolidated Appropriations Act (P.L. 112-74) plus 0.612%—\$904 million. The resolution expires on March 27, 2013.

## 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 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; and
- 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).<sup>1</sup> 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).<sup>2</sup> The MCC headquarters staff level is currently about 261, with a total of 40 additional U.S. direct hire employees in compact countries.<sup>3</sup> 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.<sup>4</sup>

Since its inception, Congress has closely followed MCC implementation. The 113<sup>th</sup> Congress will likely consider MCC funding, a possible reauthorization, and operational issues.

## 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 and applied, 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.

### Identification of Candidate Countries

The identification of initial candidate countries for possible participation in MCC programs is 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). The pool of possible participants is limited to low- and lower-middle-income countries (the former with per capita

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<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> MCC, *Agency Financial Report, Fiscal Year 2011*, p. 17.

<sup>4</sup> Current private sector board members serving their first term are Mark Green, former congressman and ambassador to Tanzania, and Morton Halperin, senior advisor for the Open Society Foundations. Serving his second term is Lorne Craner, president of the International Republican Institute. There is one vacancy. First terms run three years and second terms run two years.

incomes below \$1,945 and the latter between that figure and \$4,035 in FY2013), a total of 89 in FY2013.

This division of countries into income groups and the variability of annual income levels have created some uncertainties and problems.<sup>5</sup> Depending on the timing, a change in relative income status might exclude countries from MCC eligibility. In FY2011, Albania, a threshold program country, moved from lower-middle-income to upper-middle-income status and, therefore, became ineligible for further MCC assistance. On the other hand, Namibia, which gained upper-middle-income status in FY2010, was able to continue its compact signed in 2008, as can Jordan, a compact country that moved to upper-middle status in FY2012. Tunisia, which was made threshold program eligible in September 2011, based on its FY2011 status, moved to upper-middle-income rank in FY2012.

Because it is MCC practice to judge the performance of countries within their income status cohort—low-income countries compete with other countries in the low-income group; countries in the lower-middle-income group compete with each other—countries that move from one year to the next from low-income to lower-middle-income status may be affected negatively by being compared to countries at a higher level of development. Seeking to mitigate the negative consequences of income change, in September 2009 and in each subsequent year, the MCC Board announced that, for countries that move from low to lower-middle-income status, it would consider their performance relative to both their old income group and the newer one for a period of three years.<sup>6</sup> The FY2012 appropriations language would treat countries that moved from low-income to lower-middle income or vice versa as though they were in their former classification for that fiscal year and two succeeding years.

Perhaps the most significant impact of the two income division is that, 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 can be funded or even selected. Both the Philippines (FY2008) and Indonesia (FY2009) were selected when they were low-income countries; a year or two later and the outcome may have been different.

To address the recurring issue of income category change strictly as it affects funding eligibility, FY2012 appropriations language (P.L. 112-74), following closely provisions proposed in the recent past by authorizers (see the “Authorizing Legislation and MCC Reform” section below), made a change that the MCC is applying to the FY2013 candidate identification process. For purposes of funding eligibility, the legislation redefines the category of low-income countries from the World Bank’s characterization as those with per capita incomes below \$1,945 to one that encompasses the bottom 75 countries in the Bank’s low- and lower-middle income level rankings. The remaining countries below the Bank’s cut-off ceiling for lower-middle income countries (\$4,035 per capita in FY2013) remain defined as lower-middle in MCC terms. Applied in

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<sup>5</sup> An example of the limitations of determining eligibility based on variable factors like income level is the Philippines. The Philippines was selected for compact eligibility as a low-income country in FY2008 (and signed a compact based on that status in 2010), moved from low-income to the lower-middle-income level in FY2010, then returned to low-income status in FY2011, and again to lower-middle-income status in FY2012.

<sup>6</sup> The FY2010 Consolidated Appropriations Act (P.L. 111-117, H.R. 3288, Division F) allowed those 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. The compact for Indonesia, transitioning to lower-middle in FY2010 when it was reselected, was therefore funded as though in the low-income group.

FY2013, 75 countries are considered for MCC funding purposes as low-income versus 56 in the Bank's definition, and 14 countries are considered lower-middle income versus the Bank's 33.

In addition to the income ceiling, under the MCC authorization, countries may be candidates only if they are not statutorily prohibited from receiving U.S. economic assistance. For FY2013, 14 countries were excluded for this reason. Many had been barred in prior years as well.<sup>7</sup> Two, Madagascar and Mali, excluded in FY2010 and FY2012 respectively because of an undemocratic change in government, were compact countries and, in losing their eligibility, had their programs terminated early.

In August 2012, the MCC transmitted to Congress its annual notification of candidate countries.<sup>8</sup> For funding purposes, the revised version listed 62 low-income countries (from the original pool of 75, after excluding prohibited countries) and 13 lower-middle-income countries. For selection purposes, there are 45 low-income countries competing with each other, and 30 lower-middle-income countries competing with each other, a total of 75 candidate countries from which compact-eligible countries may be chosen. (See **Appendix C.**)

## 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 performance indicators related to these three categories, or "baskets." Indicators may be a straightforward single measure of a country's rate of inflation—one reflection of good economic policies—or may be a combination of data points forming an index of surveys and expert opinions on the quality of public service, civil servant competency, a government's ability to plan and implement sound policies, which together "measure" government effectiveness. MCC is constrained somewhat in measuring performance by the public availability of appropriate, comparable, and consistent data on every country.

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

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<sup>7</sup> Various types of aid restrictions applied to these countries. For Sudan, Madagascar, Mali, Fiji, and Guinea-Bissau, U.S. aid was blocked because an elected head of government had been deposed by a military coup. For Zimbabwe, legislation banned assistance to the central government until rule of law is restored. 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.

<sup>8</sup> MCC, *Report on Countries that are Candidates for Millennium Challenge Account Eligibility for Fiscal Year 2013 and Countries that would be Candidates but for Legal Prohibitions*, August 2012.



priorities as they ultimately determine which countries will receive U.S. assistance. Perhaps of equal significance, raising indicator scores has become a prominent objective of some developing countries in what former CEO Danilovich called the “MCC effect.”<sup>9</sup> Countries seeking eligibility are said to be moving on their own to enact reforms and take measures to improve performance scores 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.<sup>10</sup> The criteria have been altered and refined, sometimes dramatically, over time. In September 2011, the MCC Board adopted perhaps the most significant changes to its selection methods since the agency was established. To ease the transition to a new system, for the FY2012 selection round, the MCC used both “old” and “new” methods to make its judgments on compact eligibility. In FY2013, the new system is fully adopted.

As in the past, for most performance indicators, each country is judged against its peers in its income group, requiring a score just above the median to pass that indicator. For some indicators there is an absolute threshold that must be met in order to pass the indicator. The absolute threshold indicators include an “inflation rate” under 15%, “political rights” requiring a score above 17, “civil liberties” requiring a score above 25, and, for lower-middle-income countries only, an “immunization coverage” of above 90%.

Under the new system, countries no longer have to pass half the indicators in each basket to qualify; they are required to pass at least half of the total number of indicators. That total has been expanded to 20, so countries need to pass 10 in all (see **Appendix D** for a complete list of the 20 performance indicators). Of the 10, two of these are “hard hurdles” that must be passed to qualify—the “corruption” indicator as in the past, and either one of two democratic rights indicators, the “civil liberties” indicator or the “political rights” indicator. Requiring passage of a democratic rights indicator may weed out countries that achieved eligibility only to have their compact programs suspended or terminated when their governments failed to meet governance performance standards. Finally, to avoid concerns that a country could achieve compact eligibility with a passing performance in only two of the three baskets, the Board set the requirement that countries must pass at least one indicator in each basket.

The new methodology established some indicators and modified or replaced old ones, continuing an MCC effort to improve the quality of indicators and identify indicators better reflecting congressional intent. Beginning with the FY2005 selection process, for example, 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 MCC replaced a “country credit rating” with a new indicator on the “cost of starting a business” that it believed had a stronger correlation with economic growth and 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

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<sup>9</sup> MCC Public Outreach Meeting, February 15, 2007.

<sup>10</sup> Most recently, *Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2013*, September 2012.

additional policy improvements. In FY2008, the MCC collapsed the “days to start a business” and “cost of starting a business” indicators into one “business start-up” indicator.

In addition to criteria originally proposed by the Bush Administration, lawmakers in the 2004 MCC authorizing legislation 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. In FY2005, an indicator measuring girls’ primary education completion rates replaced a broader measure used in FY2004 that did not disaggregate primary education graduation by gender. In FY2008, two indicators assessing a country’s commitment to policies that promote sustainable management of natural resources were adopted.

The new system, fully adopted in the FY2013 process, modified or added new indicators under all three baskets. Under the Ruling Justly basket, a “freedom of information” indicator, including a measure of efforts to restrict internet content, replaced the “voice and accountability” indicator. Under Investing in People, a measure of “natural resource management” was split into two indicators, one focusing on “natural resource protection” that assesses whether countries are protecting up to 10% of their biomes, and, the other on “child health,” which captures the earlier indicator’s data on access to improved water, sanitation, and child mortality. The indicator on girls’ education was amended solely for lower-middle-income countries to weigh the number of female students enrolled in secondary school, rather than those completing primary school, which remains the indicator for low-income countries.

Two new indicators were added to the Economic Freedom category of performance measures. An “access to credit” indicator reflects the importance of credit in stimulating private sector growth. A “gender in the economy” indicator measures a government’s commitment to promote equal economic legal rights for both men and women.

## **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 and where they stand on the absolute threshold indicators. As noted above, it is MCC practice that low-income countries “compete” with other low-income countries and lower-middle-income countries with other lower-middle-income countries, as defined by the World Bank definitions (and not by FY2012 appropriations legislation, which is used for funding purposes only). Some time later, the MCC Board meets to select countries eligible to apply for compact assistance.

Although all of the FY2013 compact eligible selections passed the indicators test, 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 has passed half or more of the qualifying indicators in each basket but is not selected because it scores very poorly—perhaps in the lowest 25<sup>th</sup> 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.<sup>11</sup> 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 (Georgia, Mozambique, Bolivia) 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 were 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 fell 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.<sup>12</sup> In selecting Jordan, the MCC Board appears not to have been swayed by these arguments.

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

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<sup>11</sup> Comments by Paul Applegarth, then MCC CEO, at a State Department Foreign Press Center Briefing, November 9, 2004.

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

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.<sup>13</sup> 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 Bolivia’s 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.

Some countries have remained eligible despite failing performances in years following their selection. For example, Indonesia, selected in FY2009 and signing a compact in 2011, failed the corruption indicator, half the indicators, and the investing in people basket in FY2010 and FY2011. It remained compact-eligible, because Congress has allowed it to be judged and funded as a lower income country, in which case it passes the selection requirements.

Except in certain extreme circumstances, described in the “Compact Suspension and Termination” section below, countries that are already implementing compacts are generally unaffected by a decline in performance indicators. Nine of the 19 countries implementing compacts as of January 2011 would not have qualified in FY2011.<sup>14</sup> Georgia and Vanuatu had failed three years in a row; Armenia, El Salvador, Mali, and Mozambique had failed four years in a row. Morocco had failed for five years straight.<sup>15</sup> In FY2012, this picture changes dramatically; of 16 active compacts in November 2011, only 2 would fail under the new system, 5 under the old system. In FY2013, 5 of the 15 active compact countries would fail.

In not strictly following the rule of the performance indicators, the MCC has argued 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 were derived as much as a year or more previously. A country’s position vis-à-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.

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<sup>13</sup> MCC Press Release, “The Gambia Suspended From Participation in MCC Compact Program,” June 15, 2006.

<sup>14</sup> These are Armenia, Burkina Faso, El Salvador, Georgia, Mali, Mongolia, Morocco, Mozambique, and Vanuatu.

<sup>15</sup> 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—FY2013

In its FY2013 selection round, the MCC Board reselected countries in the process of preparing their compact proposals—Benin, El Salvador, Ghana, and Georgia—and newly selected Liberia, Niger, Sierra Leone for first compacts and Morocco and Tanzania as eligible to develop second compacts. Already-signed compact countries do not need to be reselected each year.

**Table I. Compact-Eligible Countries: FY2013**

| Low-Income Countries | Lower-Middle-Income Countries |
|----------------------|-------------------------------|
| Benin                | El Salvador                   |
| Ghana                | Georgia                       |
| Georgia*             | Morocco                       |
| Liberia              |                               |
| Niger                |                               |
| Sierra Leone         |                               |

## 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 in **Appendix B**.

As of March 31, 2012, 33% of MCC compact funding was in the transport sector, mostly roads; 18% was targeted on agriculture; 8% on health, education, and community services; 9% on water supply and sanitation; 11% on energy; 4% on governance, and 5% on financial services.<sup>16</sup> Counting the 26 signed compact countries to date, 56% of compact funding has gone to sub-Saharan African countries, 11% to North Africa and the Middle East, 10% to the former Soviet Union, 9% to Latin America, and 15% to Asia and the Pacific.<sup>17</sup>

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. The process to develop a compact, from eligibility to signing, is expected to take about 27 months. Only those compact proposals that demonstrate a strong relationship between the proposal and economic growth and poverty reduction will receive funding. With more countries declared eligible in the FY2013 round than for which funding is likely to be available, the MCC notes that compact development, like the selection process, will be highly competitive.

<sup>16</sup> MCC, *Semiannual Report to Congress, Submitted for Period Ending March 31, 2012*, p. 4.

<sup>17</sup> MCC, *Congressional Budget Justification FY2013*, p. 45.

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.

One of the first steps in the compact development process is the undertaking by the compact eligible country, possibly in conjunction with MCC economists or consultants, of an analysis of the principal constraints to economic growth and poverty reduction. This report seeks to identify the binding constraints that “are the most severe root causes that deter households and firms from making investments of their financial resources, time, and effort that would significantly increase incomes.”<sup>18</sup>

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.<sup>19</sup> Burkina Faso's consultations reportedly included 3,100 people in all 13 regions.<sup>20</sup>

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 results of these public deliberations and concept papers are compact proposals. These proposals 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.

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<sup>18</sup> MCC, *Compact Development Guidance*, January 2012, p. 15.

<sup>19</sup> Tanzania and Namibia examples in this section are based on author interviews.

<sup>20</sup> Rebecca Schutte, *Burkina Faso Field Report*, Center for Global Development, July 2009.

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.<sup>21</sup>

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.<sup>22</sup>

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.<sup>23</sup>

## 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, and 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.

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<sup>21</sup> MCC, *Policy Reforms Matter*, September 9, 2010.

<sup>22</sup> Details on each of the negotiated compacts can be found at the MCC website: <http://www.mcc.gov>.

<sup>23</sup> Rebecca Schutte, Center for Global Development, *Burkina Faso Field Report*, July 2009, p. 1.

In 2011, compacts with Malawi and Indonesia were signed, and, in 2012, compacts with Cape Verde and Zambia.

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 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.<sup>24</sup>

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

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<sup>24</sup> 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.



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 was the case with Honduras and Cape Verde which closed in 2010, and with Armenia, Benin, Georgia, Nicaragua, and Vanuatu in 2011, the MCC conducts impact evaluations using independent evaluators. Results of the first evaluations are expected to be made public within a year.

As projects are implemented, events may require that changes be made to compact plans.<sup>25</sup> 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 Tanzanian 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 was 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 may 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.<sup>26</sup> 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

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<sup>25</sup> For more details, see Office of Audit for the MCC, *Review of the Millennium Challenge Corporation's Compact Modifications*, M-000-12-006-S, July 16, 2012.

<sup>26</sup> "MCC Policy on Suspension and Termination", available at <http://www.mcc.gov/mcc/bm.doc/07-suspensionandterminationpolicy.pdf>.

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.<sup>27</sup>

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.

The MCC has suspended or terminated programs in the following cases (see **Appendix B** for details):

- Threshold programs have been suspended in Niger (December 2009, reinstated in June 2011), due to undemocratic actions taken by its leadership contrary to the MCC's governance criteria; suspended in Yemen (November 2005, reinstated February 2007, but never implemented) due to a pattern of deterioration in its performance criteria; and terminated in Mauritania (2008) due to aid prohibitions on governments deposed by a coup. See "Threshold Programs" section below for details.
- Compact eligibility was suspended in the Gambia (June 2006) because of "a disturbing pattern of deteriorating conditions" in half of the 16 qualifying factors.
- Portions of compacts have been terminated in Nicaragua (June 2009), because of the actions of the government inconsistent with the MCC eligibility criteria in the area of good governance; and in Honduras (September 2009), because of an undemocratic transfer of power contrary to the Ruling Justly criteria. The compact in Madagascar was terminated due to a military coup (May 2009). In Armenia (2008), 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. The Mali compact, put on operational hold in March 2012 after a military coup, was terminated in August 2012.
- Most recently, in March 2012, the MCC Board suspended the Malawi compact. This followed the placing of an operational hold on the Malawi compact in July 2011, only a few months after the compact was signed, both steps taken as a result

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<sup>27</sup> Most recently, §7008 in P.L. 111-117, Division F, the State, Foreign Operations Appropriations, FY2010.

of a pattern of actions by the Malawi government “inconsistent with the democratic governance criteria” of the MCC. The Malawi suspension was lifted in June 2012 when democratic behavior significantly improved.

In as much as there have been only 26 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 Section 611(a) in response to an undemocratic transfer/retention of power, a violation of the Ruling Justly eligibility criteria. The incidence of suspensions and terminations also suggests a weakness in the eligibility criteria that the new democratic rights “hard hurdle” for compact eligibility is meant to address. Despite these efforts by MCC, 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.<sup>28</sup> 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.

### **Anticipated Compacts in 2013**

The MCC anticipates possible board approval of second compacts with Georgia, El Salvador, Ghana, and, perhaps, Benin during 2013. Several of these compacts would draw on FY2012 funds or a combination of FY2012 and FY2013 funds.

### **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 the MCC 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 (sec. 616 of P.L. 108-199). Subsequent foreign operations appropriations have made 10% of new MCC appropriations available for this so-called threshold assistance; the FY2012 appropriations (P.L. 112-74), the terms of which carried forward under the FY2013 continuing resolution, makes 5% available for this purpose.<sup>29</sup>

In the first part of 2010, the threshold program underwent an extensive review, the result of which has led to significant changes to the program. 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.<sup>30</sup> Those countries deemed eligible for the program had to submit concept papers

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<sup>28</sup> 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>.

<sup>29</sup> Initially, assistance for threshold countries was authorized only for FY2004.

<sup>30</sup> Of the programs ongoing or completed, most have sought to improve country scores on the corruption indicator. Several countries had multiple objectives. Indonesia and Peru, for example, targeted both corruption and immunization indicators. Liberia’s program focuses on girls’ education and land rights. Timor-Leste targets corruption and childhood (continued...)

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 was 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 was not guaranteed for each country selected for the threshold program, but was based on the quality of the country plan.

Although eight threshold country programs were 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.<sup>31</sup> 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.

Following the threshold program review, 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 no longer focuses on changing specific indicator scores. Rather, it focuses on constraints to economic growth, like those identified for compact countries, but maintains the former threshold program focus on reforming policies. Working on resolving constraints to growth is believed to 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 selected only one new eligible country for the FY2011 round at the very end of the fiscal year—choosing Tunisia in September 2011—and requested no threshold funding for FY2012. Nevertheless, as noted above, funding has been made available in the FY2012 appropriations for threshold programs and, in its December 2011 meeting, the MCC Board selected Nepal and Honduras as eligible for threshold programs. The choice of Honduras, a former compact country, was made in recognition of the steps it had taken to address political and corruption concerns that likely have prevented its acceptance for a second compact. Guatemala was made threshold eligible in FY2013. While Tunisia completed a required constraints analysis in early 2013, none of the eligible countries have signed a program agreement at this time.

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(...continued)

immunization.

<sup>31</sup> 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. Funding levels for threshold programs differ, ranging from \$6.7 million for Guyana to \$55 million for Indonesia. Currently two countries are receiving threshold assistance: Liberia and Timor-Leste. Of those countries that have completed programs, Indonesia, Moldova, Burkina Faso, Jordan, Malawi, the Philippines, Tanzania, and Zambia, have begun compacts. The re-launch of Niger's previously suspended program was ended when it was made compact eligible for FY2013.

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.<sup>32</sup> One country—Niger—had its active threshold program suspended as its governance performance deteriorated.<sup>33</sup>

## Select Issues

Concerns regarding the MCC have been expressed at various points in time on its level of funding, its operations, ability to ensure project sustainability, aspects of procurement, and the risk of corruption. These and other issues are discussed below.

## 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 most years since the MCC was established, its enacted appropriation has been well below the President's request.

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<sup>32</sup> 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. 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.

<sup>33</sup> 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>. As noted above, in June 2011, following Niger's return to democratic rule, MCC announced it would reinstate the Niger program, and, in March 2012, \$2 million was approved to enable completion of education activities under the original agreement. Further work on the program ended when Niger was made compact eligible in December 2012.

**Table 2. MCC Appropriations: FY2004-FY2013**

(in \$ billions)

|                                      | FY2004 | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013             |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------------------|
| Request                              | 1.300  | 2.500  | 3.000  | 3.000  | 3.000  | 2.225  | 1.425  | 1.280  | 1.125  | 0.898              |
| Enacted<br>Appropriation             | 0.994  | 1.488  | 1.752  | 1.752  | 1.544  | 0.875  | 1.105  | 0.900  | 0.898  | 0.904 <sup>a</sup> |
| Post-<br>Rescission<br>Appropriation | 0.989  | 1.480  | 1.751  | 1.746  | 1.484  | 0.871  | 1.081  | 0.898  | 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. P.L. 112-10 includes an across-the-board 0.2% rescission in FY2011 appropriations. There was no rescission in FY2012.

a. FY2013 is amount provided by the Continuing Appropriations Resolution, FY2013 (P.L. 112-175)—the FY2012 level plus 0.612%. Resolution expires March 27, 2013.

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 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. On July 27, 2011, the State, Foreign Operations subcommittee of the House Committee on Appropriations marked up an FY2012 bill, providing \$898.2 million for the MCC, equal to the FY2011 level. The bill was not taken up by the full Committee on Appropriations. On September 22, 2011, the Senate Appropriations Committee reported S. 1601 (S.Rept. 112-85), the FY2012 State, Foreign Operations Appropriations, providing \$898.2 million, equal to the FY2012 level. On December 23, 2011, the Consolidated Appropriations Act (P.L. 112-74, H.R. 2055) was signed into law, providing \$898.2 million for the MCC in FY2012, equal to the FY2011 level and 20% less than the Administration request.

### MCC Appropriations Request and Congressional Action for FY2013

On February 13, 2012, the Administration issued its FY2013 State, Foreign Operations budget, requesting \$898.2 million for the MCC, the same amount it received in FY2012 and FY2011.

On May 24, 2012, the Senate Appropriations Committee reported S. 3241 (S.Rept. 112-172), the FY2013 State, Foreign Operations appropriations. It provides \$898.2 million for the MCC, the same amount as in FY2012 and equal to the request level. While noting its support for the MCC mission, the committee report pointed to GAO questions regarding the lack of transformational change and sustainability promised by the agency. It also called for an assessment of how compacts align with U.S. strategic interests and other U.S. aid programs, the sustainability of MCC investments, and whether lessons learned by MCC indicate a need for adjustments in its development model.

On May 25, 2012, the House Appropriations Committee reported H.R. 5857 (H.Rept. 112-494), the FY2013 State, Foreign Operations appropriations. It provides \$898.2 million for the MCC, the same amount as in FY2012 and equal to the request level. The committee report urged expeditious filling of private sector vacancies in the Board of Directors, a responsibility of congressional leadership. It required submission of a report on how to improve MCC assessments of corruption in partner countries and the process to determine whether a level of corruption merits termination of a compact. The report expressed concern over possible private equity, investment, and development funds established by MCC and sought annual audits of such funds and a report on each. The committee expected the MCC mandate of increasing economic growth and reducing poverty to be maintained and requested that the economic rates of return for each compact item be listed in new compact congressional notifications.

In September 2012, the Continuing Appropriations Resolution, 2013 (H.J.Res. 117, P.L. 112-175), was approved by Congress, providing FY2013 funding for the MCC at the level in the FY2012 Consolidated Appropriations Act (P.L. 112-74) plus 0.612%, adding \$5.5 million to the \$898.2 million FY2012 level. The resolution expires on March 27, 2013.

### **MCC Appropriations Request and Congressional Action for FY2014**

The President's budget request, usually provided in the first week of February, was delayed at least until March 2013.

### **Impact of Sequestration**

Under the Budget Control Act of 2011 (P.L. 112-25), signed into law on August 2, 2011, across-the-board reductions in budget authority (also referred to as sequestration) in every discretionary program, project, and activity were to be triggered on January 2, 2013, if legislation to reduce the deficit by \$1.2 trillion over a 10-year period between FY2012 and FY2021 was not enacted by January 15, 2012. The sequestration deadline was delayed by two months, until March 1, 2013, by the American Taxpayer Relief Act of 2012 (P.L. 112-240).

On September 14, 2012, the Office of Management and Budget (OMB), as required by the Sequestration Transparency Act of 2012 (P.L. 112-155), submitted a report to Congress with preliminary reduction estimates for discretionary budget accounts, including foreign affairs spending. The report, *OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112-155)*, indicated that most State-Foreign Operations and Related Agencies accounts, including the MCC, could see an 8.2% reduction in gross budget authority in FY2013. Sequestration would, therefore, likely cut the MCC budget by roughly \$74 million. Taking into account more recent changes to the debt and other factors, the Congressional Budget Office has calculated the possible cut to non-defense accounts at 5.3%.<sup>34</sup>

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<sup>34</sup> CBO, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, p. 14, Table 1.2, February 2013.

## Authorizing Legislation and MCC Reform

Congress has not enacted a new funding authorization since the original MCC legislation in 2004 authorized “such sums as may be necessary” for FY2004 and FY2005. The requirement of an authorization of appropriations for foreign aid programs has been routinely waived, as the Continuing Appropriations Resolution, 2013 (H.J.Res. 117, P.L. 112-175), did in the case of currently unauthorized foreign aid program appropriations, including the MCC (Section 113).

In recent years, there have been a number of efforts to amend the original MCC authorizing legislation that were unsuccessful, because their legislative vehicles failed.<sup>35</sup> In the 112<sup>th</sup> Congress, several bills were under consideration that would make policy modifications along similar lines as the earlier efforts—S. 1601, the FY2012 State, Foreign Operations Appropriations; S. 1426, a Foreign Relations Authorization bill introduced by Senator Kerry on July 27, 2011; and H.R. 2583, a Foreign Relations Authorization bill reported by the House Foreign Affairs Committee on July 21, 2011 (H.Rept. 112-223). Similar efforts may be expected in the 113<sup>th</sup> Congress.

- S. 1601 and S. 1426 would allow a compact to exceed five years in length, up to seven years, if it cannot be completed on time. This provision is deemed necessary by MCC in view of the difficulties that recipient countries may have in implementing complex projects within a limited timeframe.
- S. 1601 and S. 1426 would allow subsequent or 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. Concurrent or subsequent compacts would be allowed only if the compact country contributed 7.5% of total funding in the case of low-income countries, or 15% of funding in the case of lower-middle-income countries. Both bills contained additional provisions that would allow concurrent compacts only up to two years after the initial compact is signed and would limit compact funding to any one country to 15 years.
- S. 1601 and S. 1426 redefine low- and lower-middle-income status to place the lowest 75 lowest-income countries identified by the World Bank in the low-income group and the remaining lower-middle-income countries in the lower-middle-income level. Without this change, there are 60 countries in the low-income and 30 in the lower-middle level in FY2012. 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). The FY2012 appropriations (P.L. 112-74) contains language requiring this approach for candidate selection, which the MCC is applying in the FY2013

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<sup>35</sup> Significant policy language was offered in the 109<sup>th</sup> Congress (2006): H.R. 4014, reported by the House International Relations Committee (H.Rept. 109-563); in the 111<sup>th</sup> Congress (2010), S. 2971, reported by the Senate Foreign Relations Committee (S.Rept. 111-301); and S. 3676, the State, Foreign Operations Appropriations for FY2011, reported by the Senate Appropriations Committee (S.Rept. 111-237).



selection process. The MCC has requested continuation of this language in the FY2013 appropriations, and it is currently carried forward under the Continuing Resolution.

- S. 1601 requires that a country transitioning from low-income to lower-middle-income status or *vice versa* would retain its former classification for purposes of compact eligibility for the year of transition and two subsequent years following the transition. S. 1426 would apply this requirement for the year of transition and the three subsequent years following the transition. S. 1426 would also apply the rule to countries transitioning to upper-middle-income status. H.R. 2583 would apply it to any transition in income status, but only for the year of that transition. The FY2012 appropriations (P.L. 112-74) contains language requiring application of the S. 1601 procedure during the compact eligibility selection process. The MCC has requested continuation of this language in the FY2013 appropriations, and it also carried forward under the Continuing Resolution.

In addition to requests already noted, the MCC has in 2012 asked that several changes be enacted in its authorizing legislation. These include placing the new candidate identification reforms in its authorizing statute, allowing MCC to extend compacts in select cases for up to one year, and allowing MCC private sector Board members to remain on the Board for one year after expiration of their term in order to allow time for re-confirmation or confirmation of a successor.<sup>36</sup>

## 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 the MCCs first years of existence, however, some observers complained about the lack of measurable results.<sup>37</sup> One reason for the seeming absence of results was the slow speed of compact implementation. A second was that the first compact programs only ended in late 2010, and it was reasonable to expect that it would be some time after project closures before a serious analysis of actual impacts could be undertaken. Nonetheless, as the delay continued, a degree of impatience was not unfounded. Finally, two years after the initial compacts ended, the first evaluations were released in October 2012, focusing on five farmer training projects. About 120 other impact evaluations are promised over the next few years.<sup>38</sup>

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<sup>36</sup> MCC, *Summary of the March 22, 2012, Meeting of the Board of Directors of the Millennium Challenge Corporation*, p. 2.

<sup>37</sup> 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."

<sup>38</sup> MCC CEO Daniel Yohannes, MCC Quarterly Town Hall Meeting, September 14, 2012, based on transcript.

In fact, the agency argues that it has been producing various kinds and degrees of results since it was launched. First is the impact made by the MCC process itself. Under the so-called “MCC effect,” countries are said to be establishing reforms in an effort to qualify under the 20 performance 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). House and Senate-approved resolutions in 2007 (H.Res. 294 and S.Res. 103) noted the role the MCC played in encouraging Lesotho to adopt legislation improving the rights of married women. It can also be argued that the establishment of local compact implementation mechanisms—the MCA’s—has served a capacity building function and influenced some government’s procurement policies.

Second, assistance program inputs—financing, technical expertise, vaccines, construction, etc.—produce outputs. In lieu of reporting the more long-term impacts sought impatiently by some, MCC has in recent years been regularly reporting the immediate outputs resulting from its efforts. For instance, it notes that its programs have trained 210,851 farmers, built 830 educational facilities, completed 1,712 kilometers of roads, and constructed 11,756 sanitation systems.

Third, it argues that some of these outputs have led to medium-term outcomes, such as an increase by 20,000 in the number of new registered businesses in Albania as a result of administrative reforms made in business licensing under its threshold program. An independent analysis of the Burkina Faso threshold program found that construction of 132 primary schools led to increased enrollment for both boys and girls by about 20% and for girls over boys by 5%.<sup>39</sup> Among the outcomes of its Port of Cotonou modernization project under the Benin compact, according to MCC, are annual savings of \$2.1 million in dredging and maintenance costs and a decrease in average customs clearance time.<sup>40</sup>

The fourth and perhaps most important result from MCC activity is the long-term impact of its compacts on poverty reduction through increased incomes among poor people. Independent post-compact impact evaluations are meant to explore the relationship between an MCC investment and such an outcome, if any, so as to provide lessons for future compacts. As noted, the first such impact evaluations were published in October 2012. Examining farmer training programs conducted in five compact countries, the evaluations affirmed that the *average* of individual outputs anticipated for a country, such as the number of farmers trained and hectares under production with MCC support, met or exceeded their targets in all five cases (although for two countries a number of indicators had no targets). While the evaluations found increases in *farm* income in three countries—no measurements could be undertaken in a fourth country—in no case was it able to identify increases in *household* incomes. This finding may be due to a household reallocating other income sources to farming or because household income is too difficult to measure. In any case, MCC is looking for alternative methods for measuring household income for application to future compacts.

Some concerns have been raised by GAO regarding the possible outputs and impacts of MCC compacts. 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

<sup>39</sup> MCC Public Board Meeting, June 11, 2009. Mathematica Policy Research, Inc., *Impact Evaluation of Burkina Faso’s BRIGHT Program*, March 2009.

<sup>40</sup> MCC, *Fact Sheet: MCC’s Continuum of Results*, May 23, 2012.

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.<sup>41</sup> 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 would help Vanuatu address poverty reduction.<sup>42</sup>

A September 2012 GAO report called into question the quality of data used to determine beneficiary numbers in seven transportation projects, pointing to mistakes made in formulas used, a failure to apply a methodology to all compacts, and a failure to update numbers in public documents.<sup>43</sup> A June 2012 GAO report questioned the quality of work done on a road construction project in Georgia and noted an array of problems that have kept part of a port constructed by MCC in Benin from full operability.<sup>44</sup> Sustainability concerns were raised for both projects (see below for discussion).

## Ensuring Sustainability

An important factor in assessing the success of development assistance programs, one strongly emphasized by the MCC, is the extent to which assistance efforts are sustainable after donor support ends. As noted earlier, the MCC often conditions compact aid on country adoption of policy reforms that enhance sustainability. In Tanzania, for example, the government electric power services were required to reform their tariff schedules in order to fully recover their costs, and, in those countries with road projects, provisions have been included to ensure establishment or improvement of a road fund to pay for upkeep.

GAO reports on completed compacts, however, have questioned the effectiveness of MCC sustainability efforts in the cases it examined. In Cape Verde, the road fund reportedly met only half of maintenance requirements, and water fees, established to fund infrastructure maintenance for the watershed and agricultural support project, were not being collected in one of the three watersheds. In Honduras, a required increase in the national road maintenance budget was believed to be insufficient to meet needs and was intended to address all roads, not just those funded by the MCC. Further, farm-to-market roads provided under the Honduras compact were the responsibility of municipalities that, reportedly, lacked equipment, expertise, and funds for road maintenance.<sup>45</sup> GAO noted that, while the MCC included conditions precedent in its compact with Georgia requiring the government to maintain a level of funding for road maintenance, the government “shows limited ability to keep the road operational and well

<sup>41</sup> Government Accountability Office, *Millennium Challenge Corporation: Vanuatu Compact Overstates Projected Program Impact*, July 2007, GAO-07-909.

<sup>42</sup> Testimony of Rodney Bent before the House Committee on Foreign Affairs, Subcommittee on Asia, the Pacific, and the Global Environment, July 26, 2007.

<sup>43</sup> GAO, *Millennium Challenge Corporation: Results of Transportation Infrastructure Projects in Seven Countries*, 12-631, September 2012.

<sup>44</sup> GAO, *Millennium Challenge Corporation: Georgia and Benin Transportation Infrastructure Projects Varied in Quality and May Not Be Sustainable*, 12-630, June 2012.

<sup>45</sup> Government Accountability Office, *Millennium Challenge Corporation: Compacts in Cape Verde and Honduras Achieved Reduced Targets*, GAO-11-728, July 2011.

maintained.” It has also questioned the ability of Benin’s port authority to operate key components.<sup>46</sup>

## 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 September 2010, 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 September 2010, \$400 million 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 corruption-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 a “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

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<sup>46</sup> GAO, *Millennium Challenge Corporation: Georgia and Benin Transportation Infrastructure Projects Varied in Quality and May Not be Sustainable*, 12-630, June 2012, p. 33 and p. 47.

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 Subcommittee chair and ranking Member raised concerns regarding the absence of termination guidelines based on a pattern of corruption.<sup>47</sup>

In 2009 and 2010, several Members of Congress noted their concern regarding provision of MCC funding to corrupt countries.<sup>48</sup> 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 74<sup>th</sup> 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.

## Implications of New Eligibility Methodology

The pool of compact-eligible countries is meant to represent those more committed than others to democratic governance, investments in their people, and economic freedom, in the belief that the best-performing countries in these areas are also those more likely to effectively use MCC resources in reducing poverty and promoting economic growth. The FY2013 change to the methodology for establishing country compact eligibility status will shape the number and composition of the pool of eligible countries and may have important consequences for the future of the program. Accordingly, some of the differences between the old and new systems, both of which were used to inform the selection process during the transition year of FY2012, are worth noting:

- Under the new system, in FY2012, more countries pass the eligibility requirements than under the old system. Under the old system, 21 of the 82 candidates, nearly 26%, pass. Under the new system, 31 countries, nearly 38%, pass.
- Under the new system, the number of indicators increases from 17 to 20, possibly facilitating specific policy changes by countries seeking MCC approval. Further, in the old system, countries could pass 9 indicators to become compact eligible, 3 in

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<sup>47</sup> Hearing with Daniel Yohannes, MCC CEO, April 14, 2010.

<sup>48</sup> “For Senegal: U.S. Aid, 164-ft. Statue,” *The Washington Times*, August 16, 2010.

each basket; the new system requires 10, half of the indicators, at least 1 in each basket.

- In 13 cases, a country passes under the new system where it would have failed under the old. In these cases, the country now passes half of all the indicators, including one in each basket, whereas previously it would have failed one of the three baskets. Nine of those times, the country failed under the old system because it did not pass the Investing in People category. Two additional times, countries failed under the old system because of insufficient success in both Investing in People as well as Economic Freedom categories. In two cases, countries would have failed only the Economic Freedom basket.
- In only three cases, countries passed the old system, but failed in the new. In each case, the country failed the “democratic rights” hard hurdle introduced under the new system.
- The introduction of a pass-fail hurdle for “democratic rights” strengthens the role of democracy and governance performance in the eligibility process by making passage of one of the two indicators a requirement. But, for lower-middle-income countries, the change from use of a median to an absolute threshold for the two “democratic rights” indicators makes passing them easier than was the case under the old system, because the absolute threshold falls below the median for that level of income. The political rights requirement is a score of at least 17, but the median for lower middle income is 24. The civil liberties requirement is a score of a minimum of 25, but the median for lower middle income is 35.5. According to the MCC, the choice of threshold level reflects what the Freedom House data presents as an appropriate break between countries that are reforming and those that are not.

The new system of determining compact eligibility may affect the character of the final pool of countries the MCC supports in the way that it appears to enlarge the pool of countries overall and strengthens or diminishes the weight placed on one performance indicator or basket of indicators over another. The MCC’s objective in making these changes is to stabilize a system that had been characterized by a degree of unpredictability from year to year as countries near to the median in one or more indicators might find themselves move from pass to fail and vice versa due to no action of their own making, but because other countries had performed better or worse, or because of the imperfect and variable data collected to capture country performance. The greater weight given “democratic rights” also reflects a need to address the fact that compact suspension or termination has been attributed to performance failures in this area. Indicator changes also continue a long-standing effort to find better ways of calibrating country performance in the required baskets.

Whatever the official rules for judging scorecard results, in the end, the MCC Board maintains the flexibility to reject countries that pass the minimum requirements but show poor results in the other indicators. The Board also may consider information entirely apart from the indicators that would suggest compact success or failure.

## **Key Concerns in the Early Years of the MCC**

In its first five or six years of existence, while the MCC was developing its policies and honing its method of operations, a number of issues were raised by observers that, while no longer as prominent, continue to form a backdrop to current views.

## How Large Should a Compact Be?

At various points, 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.<sup>49</sup> 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 million-\$200 million range.<sup>50</sup> These levels could vary up or down depending on many factors, such as the number of people living in poverty, the size of the economy, and the scope of the proposed projects.

Most of the first several compacts, however, did not meet the anticipated financial allocation thresholds. Madagascar’s four-year, \$110 million compact roughly doubled U.S. assistance to the country, but did not place MCC assistance among the top donors and was also not very large relative to the country’s population. 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 likely remained in that position as MCC grants were 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 its recent American aid. While these were not insignificant amounts of new resources, they were far less than Bush Administration officials had suggested previously.<sup>51</sup> 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.

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.<sup>52</sup> After assuming the CEO position, he moved the MCC toward 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.

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<sup>49</sup> See, for example, Millennium Challenge Corporation FY2005 Budget Justification, p. 7. Found at [http://www.mcc.gov/about/reports/congressional/budgetjustifications/budget\\_justification\\_fy05.pdf](http://www.mcc.gov/about/reports/congressional/budgetjustifications/budget_justification_fy05.pdf).

<sup>50</sup> Prepared statement of Steve Radelet, Senior Fellow at the Center for Global Development, before a hearing of the House International Relations Committee, April 27, 2005.

<sup>51</sup> For example, USAID Administrator Natsios remarked in an October 22, 2002 speech at the American Embassy in London that “we estimate in most countries the MCA will provide funding 5 to 10 times higher than existing levels” of U.S. assistance.

<sup>52</sup> Prepared statement of John J. Danilovich, before the Senate Committee on Foreign Relations, September 27, 2005.

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.”

### **What Development Sectors Should the MCC Support?**

Most of the early compacts included a similar sector concentration, focusing largely on agriculture and transportation infrastructure projects. While these activities were 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 believed that social sectors, including those in health and education, should be receiving greater attention in compact design.<sup>53</sup>

As more compacts are signed, diversity in programs is creeping in—four of the more recent ones, in Lesotho, Mozambique, Tanzania, and Jordan, feature a water and sanitation component. The Morocco compact includes micro-credit and artisan crafts support among its projects. Burkina Faso and Namibia have education components.

### **How Fast Should the MCC Spend Its Funds?**

A recurrent criticism of the MCC, especially in Congress, was the seemingly slow speed of implementation, reflected, in the view of some, by the limited amount of disbursements relative to available funds. This view became, 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.

Multiple factors determined the spending rate. Since the FY2005 appropriations, Congress has required that the MCC obligate all funding for a compact up front, even though compacts are meant to last five years. It does this to ensure that funding will be available to meet the terms of the binding contract that the MCC in effect signs with another country. In its first years, the MCC, as a new initiative, 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 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.<sup>54</sup>

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<sup>53</sup> For example, James Fox and Lex Rieffel, *The Millennium Challenge Account: Moving Toward Smarter Aid*. The Brookings Institution, July 14, 2005, p. 24.

<sup>54</sup> Government Accountability Office, *Millennium Challenge Corporation: Progress and Challenges with Compact in Africa*, Testimony, June 28, 2007, GAO-07-1049T.



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 recent years. While, as of the end of September 2009, only \$889 million, or 14%, of the \$6.4 billion obligated for MCC compacts up to that point had been disbursed, by September 2011, \$3.2 billion, or 42%, of compact obligations amounting to \$7.6 billion had been disbursed.

### **What Should Be the 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.

## Appendix A. MCC Compacts

| Country       | Compact Signed | Compact Size (millions) | Entry Into Force | Compact Completion | Compact Focus   | Population Living Below \$2 p/day (%) | Human Development Index Ranking <sup>b</sup> | Other U.S. Econ. Aid: FY2012 (millions) <sup>c</sup> |
|---------------|----------------|-------------------------|------------------|--------------------|---|---------------------------------------|--|--|
| Armenia       | Mar. 27, 2006  | \$236<br>5 years        | Sept. 29, 2006   | September 2011     | -Agriculture/ irrigation<br>-Rural roads  | 12.4%                                 | 86   | \$40.0   |
| Benin         | Feb. 22, 2006  | \$307<br>5 years        | Oct. 6, 2006     | October 2011       | -Land & property<br>-Financial services<br>-Judicial improvement<br>-Port rehab | 75.3%                                 | 167  | \$28.4   |
| Burkina Faso  | July 14, 2008  | \$481<br>5 years        | July 31, 2009    |                    | - Rural land governance<br>- Agriculture<br>- Roads<br>- Education              | 81.2%                                 | 181  | \$9.0  |
| Cape Verde I  | July 4, 2005   | \$110<br>5 years        | Oct. 17, 2005    | October 2010       | -Agriculture<br>-Transport/roads<br>-Private sector                             | N/A                                   | 133  | \$0.0  |
| Cape Verde II | Feb. 10, 2012  | \$66.2<br>5 years       | —                |                    | -Water and Sanitation<br>-Land Management                                       | N/A                                   | 133  | \$0.0  |
| El Salvador   | Nov. 29, 2006  | \$461<br>5 years        | Sept. 20, 2007   | September 2012     | -Education<br>-Transport/roads<br>-Small business/farm development              | 15.2%                                 | 105  | \$25.9   |
| Georgia       | Sept. 12, 2005 | \$295<br>5 years        | April 7, 2006    | April 2011         | - Infrastructure/ gas<br>- Transport/ roads<br>- Agriculture/ business          | 32.6%                                 | 75   | \$66.7   |
| Ghana         | August 1, 2006 | \$547<br>5 years        | Feb. 16, 2007    | February 2012      | -Agriculture<br>-Transport<br>-Rural Development                                | 53.6%                                 | 135  | \$171.1  |

| Country                          | Compact Signed | Compact Size (millions) | Entry Into Force | Compact Completion | Compact Focus   | Population Living Below \$2 p/day (%) | Human Development Index Ranking <sup>b</sup> | Other U.S. Econ. Aid: FY2012 (millions) <sup>c</sup> |
|----------------------------------|----------------|-------------------------|------------------|--------------------|---|---------------------------------------|--|--|
| Honduras                         | June 13, 2005  | \$215<br>5 years        | Sept. 29, 2005   | September 2010     | -Agriculture<br>-Transport/roads  | 35.6%                                 | 121  | \$55.3   |
| Indonesia                        | Nov. 18, 2011  | \$600<br>5 years        | —                |                    | -Energy & Resource Management<br>-Health & Nutrition<br>-Public Procurement | 50.7%                                 | 124  | \$146.0  |
| Jordan                           | Oct. 25, 2010  | \$275.1<br>5 years      | —                |                    | -Clean Water and Sanitation   | 3.5%                                  | 95   | \$360.0  |
| Lesotho                          | July 23, 2007  | \$362.6<br>5 years      | Sept. 17, 2008   |                    | -Water sector<br>-Health sector<br>-Private sector                          | N/A                                   | 160  | \$28.1   |
| Madagascar (terminated May 2009) | April 18, 2005 | \$110<br>4 years        | July 27, 2005    | May 2009           | - Land titling/ Agriculture<br>- Financial sector                           | 89.6%                                 | 151  | \$50.6   |
| Malawi                           | April 7, 2011  | \$350.7<br>5 years      | —                |                    | -Electric power   | 90.5%                                 | 171  | \$142.9  |
| Mali (terminated August 2012)    | Nov. 13, 2006  | \$460.8<br>5 years      | Sept. 17, 2007   | August 2012        | -Irrigation<br>-Transport/ airport<br>-Industrial park                      | 77.1%                                 | 175  | \$133.3  |
| Moldova                          | Jan. 22, 2010  | \$262<br>5 years        | Sept. 1, 2010    |                    | -Agriculture<br>-Roads  | 12.5%                                 | 111  | \$21.0   |
| Mongolia                         | Oct. 22, 2007  | \$285<br>5 years        | Sept. 17, 2008   |                    | -Transport/rail<br>-Property Rights<br>-Voc Ed<br>-Health                   | N/A                                   | 110  | \$3.0  |

| Country     | Compact Signed  | Compact Size (millions) | Entry Into Force | Compact Completion | Compact Focus   | Population Living Below \$2 p/day (%) | Human Development Index Ranking <sup>b</sup> | Other U.S. Econ. Aid: FY2012 (millions) <sup>c</sup> |
|-------------|-----------------|-------------------------|------------------|--------------------|---|---------------------------------------|--|--|
| Morocco     | August 31, 2007 | \$697.5<br>5 years      | Sept. 15, 2008   |                    | -Agriculture/ Fisheries<br>-Artisan Crafts<br>-Financial Serv/ Enterprise Support | 14.0%                                 | 130  | \$16.5   |
| Mozambique  | July 13, 2007   | \$506.9<br>5 years      | Sept. 22, 2008   |                    | -Water and Sanitation<br>-Transport<br>-Land Tenure/ Agri                         | 81.6%                                 | 184  | \$357.6  |
| Namibia     | July 28, 2008   | \$305<br>5 years        | Sept. 16, 2009   |                    | - Education<br>- Tourism<br>- Agriculture   | N/A                                   | 120  | \$90.8   |
| Nicaragua   | July 14, 2005   | \$175<br>5 years        | May 26, 2006     | May 2011           | - Land titling/Agriculture<br>- Transport roads                                   | 31.9%                                 | 129  | \$11.8   |
| Philippines | Sept. 23, 2010  | \$434<br>5 years        | May 25, 2011     |                    | -Revenue Reform<br>-Community Dev<br>-Road Rehab                                  | 45.0%                                 | 112  | \$114.1  |
| Senegal     | Sept. 16, 2009  | \$540<br>5 years        | Sept. 23, 2010   |                    | -Roads<br>-Irrigation   | 60.4%                                 | 155  | \$105.5  |
| Tanzania    | Feb. 17, 2008   | \$698<br>5 years        | Sept. 15, 2008   |                    | -Transport/roads, airport<br>-Energy<br>-Water                                    | 87.9%                                 | 152  | \$530.1  |
| Vanuatu     | March 2, 2006   | \$66<br>5 years         | April 28, 2006   | April 2011         | -Transport rehab<br>-Public Works Dept.   | NA                                    | 125  | \$0.0  |
| Zambia      | May 10, 2012    | \$354.8<br>5 years      | —                |                    | -Water Supply and Sanitation  | 81.5%                                 | 164  | \$367.8  |

**Sources:** Population Living Below \$2 Per Day—data is most recent survey available, from the World Bank, *World Development Report, 2012*; 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, 2011*. MCC Information: MCC.

- b. 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 enrollment 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 (2011) evaluates 187 countries, with number 1 having the best HDI and number 187 scoring the worst in the Index.
- c. Other U.S. Economic Aid is defined here as Global Health, Development Assistance, Economic Support Fund, and Assistance to Europe, Eurasia, and Central Asia accounts.

## Appendix B. Compact Descriptions and Status

Descriptions and key developments in the 26 signed compacts undertaken by the MCC since 2004 are provided below in alphabetical order. Compact funding totals include administrative and monitoring costs.

### *Armenia*

The five-year, \$236 million compact, completed in September 2011, concentrated on the agricultural sector, investing in the rehabilitation of rural roads (\$67 million) and improving irrigation (\$146 million). When launched, the program anticipated that it would 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 were raised both prior to and during implementation of the Armenia compact. In September 2005, during compact development, the MCC expressed concerns with Armenian officials regarding slippage on two of the governance indicators and matters raised by international groups concerning political rights and freedoms in the country. Moreover, the MCC Board delayed final approval of the compact following the November 27, 2005, constitutional referendum, after allegations of fraud, mismanagement, limited access by the press, and abuse of individuals were raised. In signing the compact on March 27, 2006, the MCC issued a cautionary note, signaling that Armenia must maintain its commitment to the performance indicators or risk suspension or termination of the compact. On March 11, 2008, the MCC issued a warning that assistance might be suspended or terminated in response to the government's actions, including the imposition of a state of emergency and restrictions on press freedoms.<sup>55</sup> 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.<sup>56</sup> 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.<sup>57</sup>

### *Benin*

The five-year, \$307 million compact, completed in October 2011, focused on four sectors—land rights, reducing the time and cost of obtaining property title; financial services, helping micro, small, and medium-sized businesses; justice reform, assisting the judicial system's capacity to resolve business and investment claims; and market access, improving the Port of Cotonou. When

<sup>55</sup> See letters of John Danilovich to Armenia President Robert Kocharyan on December 16, 2005 and March 11, 2008 on MCC website.

<sup>56</sup> MCC, Public Outreach Meeting Transcript, December 12, 2008, p. 12.

<sup>57</sup> Lorne Craner at Public Outreach Meeting, June 11, 2009.

launched, the compact's goal was to benefit 5 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.

### ***Cape Verde I***

The five-year, \$110 million compact, completed in October 2010, focused largely on improving the country's investment climate, transportation networks, and agriculture productivity. The program's goal was 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 to 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.

### ***Cape Verde II***

Cape Verde's \$66.2 million second compact will address two issues impeding economic growth. A water and sanitation project (\$41 million) aims to reform the regulatory regime and utility structure and provide capital infrastructure improvements. A land management project (\$17 million) is expected to induce legal reforms and the clarification of property rights. Meeting an MCC requirement for second compacts, the government of Cape Verde will contribute an additional 15% of total costs toward project implementation.

### ***El Salvador***

The five-year, \$461 million compact, completed in September 2012, addressed 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), were the chief elements of program.

### *Georgia*

The \$395 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 (\$311.7 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 1 million Georgians.

The original compact agreement totaled \$295 million, but, 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, making the total \$395 million. Complementing or completing projects begun in the original compact, it was 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, which ended in February 2012, focused on agriculture and rural development. Poverty rates in the three targeted geographic areas were above 40%. The agriculture component (\$241 million) provided training for farmer-based organizations, improved irrigation, greater access to credit, and rehabilitated local roads. The transport component (\$143 million) sought 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) constructed and rehabilitated 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 in September 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.<sup>58</sup>

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

### *Indonesia*

The five-year, \$600 million compact has three projects. A Green Prosperity project (\$332.5 million) will provide technical expertise and funding for renewable energy and natural resource management efforts that aim to raise household incomes. A community-based health and nutrition project (\$131.5 million) is aimed at reducing stunting, from which more than one-third of Indonesia's children suffer. A public procurement reform project (\$50 million) seeks to implement practices that will counter fraud, waste, and abuse that results in the loss of billions of dollars annually.

### *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 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

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<sup>58</sup> See MCC Congressional Notification, September 17, 2009, at <http://www.mcc.gov/mcc/bm.doc/cn-091709-honduras.pdf>.



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, signed in April 2011, 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). In July 2011, the compact, which had not yet entered into force, was put on operational hold in response to concerns raised by several anti-democratic actions taken by the government, including suppression of the media and prevention of peaceful protests. In March 2012, the compact was suspended in view of the continuing pattern of actions “inconsistent” with good governance. On June 26, 2012, the MCC reinstated its compact with Malawi. A change in the country's leadership and subsequent steps to restore democratic society led the Board to change its position.

### *Mali*

The compact was due for completion in September 2012. However, on March 22, 2012, the MCC announced it was halting its operations in Mali, following a military coup. The compact was formally terminated in August 2012.

The five-year, \$461 million compact emphasized an increase in agricultural production and expansion of trade. About half the funds (\$234.6 million) supported a major irrigation project, including modernization of infrastructure and improvements in land tenure. Improvements in the airport (\$89.6 million) targeted 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 were reallocated to the airport project. The early termination left some components uncompleted, including the airport terminal building and half of a 80 km road.

### *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, and 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, ended 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 June 2009, due to government actions that "limited the activity of political opposition, civil society, media elections and observers" prior to the municipal elections,<sup>59</sup> and were judged by MCC to be a pattern of action "inconsistent with the criteria used by MCC to determine eligibility for assistance,"<sup>60</sup> 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).

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<sup>59</sup> 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>.

<sup>60</sup> 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, and 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.

### *Zambia*

The \$354.8 million, five-year compact, focuses entirely on the water and sanitation sector in the Lusaka area. Most of the funds (\$284 million) will be used to rehabilitate and improve infrastructure; other funds will go for strengthening management and policy controlling the water sector.

## Appendix C. MCC Candidate Countries FY2013

(Divided into World Bank Income Categories)

| <b>Africa – Low Income</b>                  |   | <b>East Asia/Pacific – Low Income</b>              | <b>Latin America – Low Income</b>           |
|---|---|--|---|
| Benin (FC): Second Compact Eligible FY12&13 | Senegal (C)   | Cambodia   | Haiti                                       |
| Burkina Faso (C)                            | Sierra Leone: Compact eligible FY13                 | Laos   | Nicaragua (FC)                              |
| Burundi                                     | Somalia   | Papua New Guinea                                   |   |
| Central African Republic                    | Tanzania (C): 2 <sup>nd</sup> Compact Eligible FY13 | Solomon Islands                                    | <b>Latin America – Lower-Middle Income</b>  |
| Chad  | Togo  | Vietnam  | Belize                                      |
| Comoros                                     | Uganda  | <b>East Asia/Pacific – Lower-Middle Income</b>     | Bolivia *                                   |
| Cote D'Ivoire                               | Zambia (C)  | Indonesia (C) *                                    | El Salvador(C): Compact eligible FY12&13    |
| Democratic Republic of Congo                | <b>Africa – Lower Middle Income</b>                 | Kiribati *   | Guatemala *: Threshold eligible FY13        |
| Djibouti                                    | Cape Verde (CII)                                    | Marshall Islands                                   | Guyana                                      |
| Ethiopia                                    | Congo, Republic of *                                | Micronesia *                                       | Honduras (FC): Threshold eligible FY12&13 * |
| Gambia                                      |   | Mongolia (C) *                                     | Paraguay                                    |
| Ghana (FC) : Compact Eligible FY11& 12&13   | <b>South Asia – Lower Income</b>                    | Philippines (C) *                                  |   |
| Kenya                                       | Afghanistan   | Samoa  | <b>Europe - Low Income</b>                  |
| Lesotho (C)                                 | Bangladesh  | Timor-Leste (TC) *                                 | None  |
| Liberia (TC): Compact eligible FY13         | India   | Tonga  | <b>Europe – Lower-Middle Income</b>         |
| Malawi (C)                                  | Kyrgyz Rep.   | Vanuatu (FC) *                                     | Albania                                     |
| Mauritania                                  | Nepal: Threshold eligible FY12&13                   |  | Armenia (FC)                                |
| Mozambique (C)                              | Pakistan  | <b>Mid-East – Low Income</b>                       | Georgia (FC): Compact Eligible FY11&12&13 * |
| Niger: Compact eligible FY13                | Tajikistan  | Yemen  | Kosovo                                      |
| Nigeria                                     | Uzbekistan  | <b>Mid-East – Lower-Middle Income</b>              | Moldova (C) *                               |
| Rwanda                                      | <b>South Asia – Lower-Middle Income</b>             | Egypt *  | Ukraine                                     |
| Sao Tome & Principe                         | Bhutan *  | Iraq *   |   |
|   | Sri Lanka *   | Morocco (C): 2 <sup>nd</sup> Compact Eligible FY13 |   |

**Notes:** Under World Bank Income Categories: Low Income = Per capita income \$1,945 and below; Lower-Middle Income = Per capita income above \$1,945 and below \$4,035. Excluded from this table are countries prohibited from receiving U.S. economic assistance.

**(C)** = Current Compact Country; **(CII)** = Second Compact Country; **(FC)** = Former Compact Country; **(TC)** = Current Threshold Country.

\* Countries denoted by asterisk are considered Low Income for MCC funding purposes only under P.L. 112-74, defined as bottom 75 countries in income level.

## Appendix D. MCC Performance Indicators FY2013

| Ruling Justly  | Investing in People  | Economic Freedom  |
|--|--|---|
| <p><b>Control of Corruption</b><br/>Source: World Bank/Brookings World Governance Indicators (WGI)</p> | <p><b>Primary Education Expenditure as % of GDP</b><br/>Sources: UNESCO and National governments</p>   | <p><b>Inflation</b><br/>Source: IMF World Economic Outlook</p>  |
| <p><b>Freedom of Information</b><br/>Source: Freedom House/ONI/FRINGE</p>                              | <p><b>Girls' Primary Education Completion Rate (For Lower Income Countries)</b><br/>Source: UNESCO</p> <p>or</p> <p><b>Girls' Secondary Education Enrollment Rate (For Lower-Middle Income Countries)</b><br/>Source: UNESCO</p> | <p><b>Fiscal Policy</b><br/>Source: IMF World Economic Outlook</p>  |
| <p><b>Government Effectiveness</b><br/>Source: World Bank/Brookings WGI</p>                            | <p><b>Health Expenditure as % of GDP</b><br/>Source: World Health Organization (WHO)</p>   | <p><b>Trade Policy</b><br/>Source: The Heritage Foundation</p>  |
| <p><b>Rule of Law</b><br/>Source: World Bank/Brookings WGI</p>   | <p><b>Immunization Rates: DPT and Measles</b><br/>Source: World Health Organization (WHO)</p>  | <p><b>Regulatory Quality</b><br/>Source: World Bank/Brookings WGI</p>   |
| <p><b>Civil Liberties</b><br/>Source: Freedom House</p>  | <p><b>Child Health</b><br/>Sources: Columbia Center for Int'l Earth Science Info Network (CIESIN) and Yale Center for Env. Law and Policy (YCLEP)</p>  | <p><b>Business Start-Up: Days and Cost of Starting a Business</b><br/>Source: International Finance Corporation</p>   |
| <p><b>Political Rights</b><br/>Source: Freedom House</p>   | <p><b>Natural Resource Protection</b><br/>Sources: Columbia Center for Int'l Earth Science Info Network (CIESIN) and Yale Center for Env. Law and Policy (YCLEP)</p>   | <p><b>Land Rights and Access</b><br/>Source: Int'l Fund for Agricultural Development (IFAD) and Int'l Finance Corporation</p> <p><b>Access to Credit</b><br/>Source: International Finance Corporation</p> <p><b>Gender in the Economy</b><br/>Source: World Bank</p> |

## **Author Contact Information**

Curt Tarnoff  
Specialist in Foreign Affairs  
ctarnoff@crs.loc.gov, 7-7656