

**IS THE MILLENNIUM CHALLENGE CORPORATION
OVERSTATING ITS IMPACT: THE CASE OF
VANUATU**

HEARING

BEFORE THE

SUBCOMMITTEE ON ASIA, THE PACIFIC, AND
THE GLOBAL ENVIRONMENT

OF THE

COMMITTEE ON FOREIGN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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JULY 26, 2007
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Serial No. 110-140
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Printed for the use of the Committee on Foreign Affairs



Available via the World Wide Web: <http://www.foreignaffairs.house.gov/>

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U.S. GOVERNMENT PRINTING OFFICE

36-992PDF

WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
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IS THE MILLENNIUM CHALLENGE CORPORATION OVERSTATING ITS IMPACT: THE CASE OF VANUATU

THURSDAY, JULY 26, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ASIA, THE PACIFIC,
AND THE GLOBAL ENVIRONMENT,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:10 p.m. in room 2172, Rayburn House Office Building, Hon. Eni F.H. Faleomavaega (chairman of the subcommittee) presiding.

Mr. FALEOMAVAEGA. The subcommittee hearing will come to order. This is the Subcommittee on Asia, the Pacific, and the Global Environment. It will be conducting a hearing, as has already been stated in the program. And proceeding, I will begin this hearing by sharing with the witnesses and the audience my opening statement. In due time I am sure my good friend, the distinguished gentleman from Indiana Mr. Burton will be here also to present his opening statement, and I am also happy to have the distinguished lady from California as a former Ambassador to the Federated States of Micronesia, now as a Member of Congress representing the State of California, Congresswoman Diane Watson.

Some 5 years ago, the President announced a dramatic new foreign assistance program called the Millennium Challenge Account designed to change the way the United States provides aid to developing nations. There can be no doubt the approach has made some great strides, but we are here today to ensure those strides are accurately predicted, measured and assessed for future policies.

The Millennium Challenge Account was initially heralded by the administration, even by this Congress and by the development community, as a revolutionary approach of delivering foreign aid. The premise was that foreign aid works best in conjunction with adopting sound economic policies and democratic values. When governments make those crucial commitments, our Government is committed to fund them, and since its inception in 2004, the Millennium Challenge Corporation, the administering agency, was responsible for implementing the Millennium Challenge Account, the signed compacts totaling approximately \$3.8 billion, with 12 partnering countries. Most recently we rewarded our democratic friends in Mozambique in Africa with commitments totaling nearly \$830 million.

The Millennium Challenge Corporation has stated time and again that it is guided by the principle that transformative economic growth occurs and succeeds in reducing poverty when countries take full responsibility for their own development. Partnership and complete engagements are the ingredients for successful developing policies.

This committee in the past has been supportive of these guiding principles; however, we have serious questions about the availability and the capability of the MCA to fulfill these goals, questions that bring us to the topic of the hearing today.

On March of last year, the Millennium Challenge Corporation signed a \$65.7 million compact with the Republic of Vanuatu focusing primarily on rehabilitating transportation infrastructures such as roads, wharves, airstrips and warehouses. Although the compact is MCC's smallest in absolute dollars, it actually provides by far the largest amount relative to Vanuatu's population and gross domestic product. The Millennium Challenge Corporation said publicly that it expects the Vanuatu compact to have a transformative impact on the country's economy, increase in per capita income and GDP, and benefits some 60,000 poor and rural people.

It was requested of the General Accounting Office to review both the structure and the projected economic impact of the MCC \$6.7 million compact with Vanuatu. For the benefit of my colleagues, Vanuatu is a South Pacific Island country which was formerly colonized by the British and the French. The population is about 207,000 people. The per capita income is at \$1,600 per annum, and about half of the population live on less than \$1 a day. Foreign aid is about \$31 million. This is 3 years ago. Among the largest donor countries are Australia, New Zealand and Japan. Our country, I think, gave about \$2.2 million in foreign assistance. There is presence of our Peace Corps, and that amounts to about \$2.1 million in terms of our presence in the Peace Corps.

At the request of the chairman, the GAO examined the MCC's methodologies of projecting economic benefits, the MCC's portrayal and analysis of the projected benefits and risks that may affect the compact's impact. The GAO examined the extent to which the Vanuatu compact capitalizes on the lessons learned from similar United States-funded development programs in the region. It also evaluated the extent to which the MCC's analysis for determining both economic rates of return and poverty reduction could be improved regarding Vanuatu and other countries receiving compacts.

The GAO report findings call into serious question the Millennium Corporation—the MCC's ability to have a real transformative impact for compact countries. The GAO found the MCC's portrayal of Vanuatu's deal's impact does not reflect the data and analysis underlying the projections of the compact's benefits. First the MCC statement suggests as a result of the compact, average income in Vanuatu would be 15 percent higher in 2010 and 37 percent higher in the year 2015 than they would be without the compact. However, MCC's underlying data show that these percentages are cumulative. They represent the sum of increases that MCC projects for each year and uses 2005 as the baseline.

On the other hand, GAO's analysis of MCC's data shows that actual gain in per capita income relative to income in 2005 will be

3.9 percent in 2010 or 4.6 percent in the year 2015. According to the GAO report, the MCC also states that GDP will increase by an additional 3 percent in Vanuatu thanks to the compact. But its data show that actual GDP growth of 6 percent in 2007, that the economy's growth will remain constant at about 3 percent as it would without the compact.

Finally, the GAO finds that the MCC severely overstated the compact's projected impact on poverty. The MCC has stated that the compact would benefit approximately 65,000 poor people in the rural areas in using the roads to access markets and social services. However, the underlying data as analyzed by the GAO show that only 43 percent of the financial benefits are expected to go to the local population, and the MCC cannot even guarantee that all of these benefits will go to the rural poor. The remaining 57 percent of the benefits are expected to accrue to other beneficiaries, including expected tourism, service providers, transport providers, the Vanuatu Government and local businesses.

How can we be expected to believe that the Vanuatu compact will have a transformative impact on poverty when most of the benefits will be lavished on expatriates and big businesses? This strategy does not appear to dovetail with the broad philosophy of international economic development to lift the poor.

But in fairness to the MCC, the GAO report was embargoed until yesterday, and I do not know if the MCC has had time to review the report and therefore to make proper responses, but if these findings are true, the case of Vanuatu as documented by the GAO paints a grim picture for MCC's future. For a program that has been championed by the administration and even the Congress as the new and most effective way to deliver foreign aid, it appears that the case of the Vanuatu compact may undermine that very argument.

What is baffling is that these inaccuracies and over claims as stated by the GAO are occurring with the compact that is minuscule compared to the more recent compacts, which are in the range from \$350 million to \$550 million each. What does this say about the MCC's advertised transformative impacts in the larger countries?

I might also want to note that this request for the GAO study was not to single out the Republic of Vanuatu as an adversary or a country that is questionable in terms of its efforts to fulfill the necessary requirements and the paperwork that was submitted to the Millennium Account Corporation for consideration. The bottom line is again whether our friends downtown in the administration and the officials involved here kind of stretch things a little bit to announce the great progress and effectiveness of the program if, in fact, that it is simply not the case.

I look forward to hearing from our friends representing the MCC, as well as the representative of the GAO office. And at this time before proceeding further, I would like to turn the time over to my good friend, former chairman, which I had the honor of serving as a member of the Subcommittee on the Western Hemisphere, Congressman Burton, for his opening statement.

[The prepared statement of Mr. Faleomavaega follows:]

PREPARED STATEMENT OF THE HONORABLE ENI F.H. FALEOMAVAEGA, A REPRESENTATIVE IN CONGRESS FROM AMERICAN SAMOA, AND CHAIRMAN, SUBCOMMITTEE ON ASIA, THE PACIFIC, AND THE GLOBAL ENVIRONMENT

More than 5 years ago, the President announced a dramatic, new foreign assistance program, the Millennium Challenge Account, designed to change the way the United States provides aid to developing nations. There can be no doubt the approach has made some great strides, but we are here today to ensure those strides are accurately predicted, measured, and assessed for future policies.

The Millennium Challenge Account was initially heralded by the Administration, by Congress, and by the development community as a revolutionary approach to delivering foreign aid. The premise was that foreign aid works best in conjunction with adopting sound economic policies and democratic values. When governments make those crucial commitments, we fund them.

Since its inception in 2004, the Millennium Challenge Corporation, responsible for implementing the Millennium Challenge Account, has signed compacts totaling approximately \$3.8 billion with 12 partner countries. Most recently, it rewarded our democratic friends in Mozambique and Lesotho with commitments totaling nearly \$830 million.

The Millennium Challenge Corporation has stated time and again that it is guided by the principle that transformative economic growth occurs and succeeds in reducing poverty when countries take full responsibility for their own development. Partnership and complete engagement are the ingredients for successful development policies.

This Committee, in the past, has been supportive of these guiding principles. However, we have serious questions about the ability and reach of the MCA to fulfill these goals—questions that bring us to the topic of the hearing today.

In March, 2006, the Millennium Challenge Corporation signed a \$65.7 million compact with Vanuatu, focusing primarily on rehabilitating transportation infrastructure, such as roads, wharves, an airstrip, and warehouses. Although the compact is MCC's smallest in absolute dollars, it actually provides by far the largest amount relative to Vanuatu's population and gross domestic product.

The MCC said publicly that it expects the Vanuatu compact to have a "*transformative impact*" on the country's economy, increasing per capita income and GDP and benefiting 65,000 poor and rural people. In turn, the Chairman of the Full Committee, my distinguished colleague Mr. Lantos, logically and appropriately commissioned the Government Accountability Office to review both the structure and the projected economic impact of the MCC's \$65.7 million compact with Vanuatu.

Importantly, at the request of Chairman Lantos, the GAO examined the MCC's methodologies of projecting economic benefits, the MCC's portrayal and analysis of the projected benefits, and risks that may affect the compact's impact. The GAO examined the extent to which the Vanuatu compact capitalizes on the lessons learned from similar U.S.-funded development programs in the region. It also evaluated the extent to which the MCC's analyses for determining both economic rates of return and poverty reduction could be improved regarding Vanuatu and other countries receiving compacts.

The GAO report findings call into serious question the MCC's ability to have a real transformative impact on "compact" countries. The GAO found that the MCC's portrayal of the Vanuatu deal's impact does not reflect the data and analysis underlying its projections of the compact's benefits.

First, MCC's statements suggest that as a result of the compact, average incomes in Vanuatu will be 15 percent higher in 2010 and 37 percent higher in 2015 than they would be without the compact. However, MCC's underlying data show that these percentages are cumulative—they represent the sum of increases that MCC projects for each year and uses 2005 as a baseline. On the other hand, GAO's analysis of MCC's data shows that actual gains in per capita income, relative to income in 2005, would be 3.9 percent in 2010 or 4.6 percent in 2015.

According to the GAO report, the MCC also states that GDP will increase by an additional 3 percent a year in Vanuatu thanks to the pact. But its data show that after GDP growth of 6 percent in 2007, the economy's growth will remain constant at about 3 percent, as it would without the compact.

Finally, the GAO finds that the MCC severely overstated the compact's projected impact on poverty. The MCC has stated that the compact would benefit "approximately 65,000 poor, rural inhabitants living nearby and using the roads to access markets and social services." However, the underlying data, as analyzed by GAO, show that only 43 percent of the financial benefits are expected to go to the local population, and the MCC cannot even guarantee that all of these benefits will go to the rural poor. The remaining 57 percent of the benefits are expected to accrue

to other beneficiaries, including expatriate tourism services providers, transport providers, the Vanuatu government, and local businesses.

How can we be expected to believe that the Vanuatu compact will have a transformative impact on poverty when most of the benefits will be lavished on expatriates and big businesses? This strategy does not appear to dovetail with the broad philosophy of international economic development to help lift the poor.

But, in fairness to the MCC, the GAO report was embargoed until yesterday and I do not know if the MCC has had time to review the report or respond to these findings. But if these findings are true, the case of Vanuatu as documented by the GAO paints a grim picture for MCC's future. For a program that has been championed by the Administration as the new and most effective way to deliver foreign aid, it appears that the case of the Vanuatu compact may undermine that very argument.

What is baffling is that these inaccuracies and over-claims occurred with a compact that is miniscule compared to the more recent compacts, which are range from \$350 million to \$550 million each. What does this say about MCC's advertised transformative impacts in the larger countries?

I look forward to hearing the MCC's response to the GAO report and I welcome our witnesses.

Mr. BURTON. Thank you very much, Mr. Chairman. I am taking the place of Mr. Manzullo, who is the Ranking Republican on the committee, today because he has a very important interest in a farm bill that is pending right now. So I apologize for him not being here.

Mr. FALEOMAVAEGA. You don't need to apologize, sir. The fact is he is more worried about his cattle than I am my fish. So it is a fair transfer that we had yesterday when we dialogued. I do appreciate very much your pinch-hitting for Mr. Manzullo.

Mr. BURTON. No problem.

I just want to say this is an important hearing, and I am glad that you are holding it. The Millennium Challenge Corporation agreement with the Government of Vanuatu—you have to forgive me because there are so many parts of the world with which I am not really familiar. I have been to Guam, Saipan.

Mr. FALEOMAVAEGA. It is a former British and French colony. The people speak excellent French, by the way.

Mr. BURTON. My wife would love that. She studied in Paris for 7 years. So I will take her down to Vanuatu if I have a chance.

Anyhow, let me say that there is no question there has been problems with the Millennium Challenge Account. I have not seen the GAO report to which you referred, but I would like to see it, read it. And I understand it was either released just recently or was going to be released very quickly.

It troubles me from what I have heard and from what the ranking members heard about how the MCC has been applied to Vanuatu, And I am anxious to hear from Mr. Gootnick and Mr. Bent today.

But I would just like to say one thing. The United States is a very philanthropic country, and we are trying our best through a number of channels to help countries around the world, including Vanuatu. And if there are problems, we want to know about them. And if there are problems, we want to get them solved.

So without further ado, I just will say I look forward to the testimony, and I hope to learn as much as possible about the problems that we are talking about today. Thank you, Mr. Chairman.

Mr. FALEOMAVAEGA. I thank the gentleman for his opening statement.

I think there is also something else that I need to share with my colleagues and also with the public. There always seems to be criticism from other nations suggesting that our country does not give enough in foreign assistance. Not only have we developed what I think is a tremendously successful program, but many of our friends in other countries don't realize that our membership in the World Bank, the International Monetary Fund, Asian Development Bank raised somewhere between 25 to 30 percent of the assets. The contributions come from the American taxpayers, and that goes to a tremendous amount of assistance that our country has given to foreign nations.

So I just want to share that with my good friend and members of the committee as to—as you said, I cannot say more to the fact that our country literally has given more than its fair share of its wealth in sharing or giving assistance to those countries that are in need financially.

I now have the distinguished lady from California, Congresswoman Watson, for her opening statement.

Ms. WATSON. Thank you so much, Mr. Chairman, for this hearing, and I think it is the beginning of taking a real hard look at all aspects of our foreign assistance delivery system.

I, too, am concerned about some of the problems that the Millennium Challenge Corporation has had in the past, and I welcome the opportunity to take some time to examine them. But I hope we can look forward at the promise of the MCC and some of the things it is accomplishing under the leadership of Ambassador Danovich. And we were together at the beginning of the week giving a very positive promotion to what is being done, and we are really pleased we are making a difference and they are making a difference for their people.

The key issue in this hearing seems to be the predicted benefits that will accrue to the people of Vanuatu as a result of the MCC's supportive projects underway there, and this is a very important issue. I have been an outspoken advocate for improving both the quality and the utility of measured results for foreign assistance, and we need good metrics on foreign assistance to know if our investments are truly achieving positive results. And I think that the GAO report raises some important issues for MCC to consider moving forward with future projects, but I think it is important to keep this feedback in perspective.

This GAO report gives important lessons for future MCC projects. The MCC is under good leadership, and for the true test of that leadership is how they incorporate the lessons that appear in the GAO's study. And I expect we will hear from Mr. Bent that they have plans in place to do so. Furthermore, I would hope my colleagues do not interpret the results of this report as an indictment of the MCC approach, and I think we can all agree that MCC is pursuing a strategy long overdue in the United States foreign assistance, identifying those countries that are well governed, and permitting them to craft a development strategy tailored to their own needs, and supporting them as they seek to lift their people from poverty through economic growth.

MCC cannot and should not replace traditional foreign assistance, but it is a powerful and necessary tool for the United States

to fight poverty around the world. And, Mr. Chairman, I think it is important for us to look very carefully at MCC and our entire U.S. foreign assistance delivery system, because I fear there has been a lack of effective leadership over this evolved pillar of U.S. foreign policy.

But I think there are a great deal of positive lessons to draw from the successes of the MCC, and I hope we can support it as it works to strengthen and expand its efforts. And I think its original concept and direction are promising, and I hope the MCC's future efforts will bring many, many more successes, but I also think there are larger questions to address here.

Foreign assistance is America's tool for reducing poverty and giving people around the world the tools for improving themselves, their communities and their own countries. We do not give foreign aid simply because we are generous. We do it because the reduction of widespread poverty makes America safer, and it is the right thing to do. We give foreign aid because hungry, desperate people are more likely to blame us for their problems, and because people who see the United States as a tangible force for good are less likely to do us harm. In this way, foreign aid is a key component of a comprehensive U.S. national security strategy, every bit as important as our investment in military power.

But we have not been doing our duty to make this investment really work, and I think there has been an appalling lack of leadership from our administration. When the President sold us on the MCC in the beginning, he promised us that the MCC would be funded with additional dollars and would not rob from existing foreign aid programs. Unfortunately this has not been the case. And so when MCC gets criticized, I think it is the wrong place to place the criticism, and I believe that the administration bears responsibility for the current problems that our foreign assistance programs have at this time. And I would like to say clearly to them, you can't call for foreign assistance as a pillar of America's national security strategy and then fail to fund the resources to support it.

So we really need to decide what is important to us. Would we rather have a robust set of institutions to advance our national security and fight global poverty, or do we want to keep shilling for the extension of the tax cuts that really drain our pool of resources? So we need to first ask ourselves that question, how are we going to fund this program that we promised would really help poverty around the globe?

So these are questions, Mr. Chairman, that I think this hearing will start to open up, and I hope that we will have the answers and we can really fulfill our commitment and the concept of MCC.

Thank you so much, and I yield back my time.

Mr. FALCOMA. I thank the gentlelady for her most eloquent statement.

We are also joined this afternoon by another senior member of the House Foreign Affairs Committee and my dear friend and colleague, the gentleman from California, Congressman Rohrabacher.

Do you have an opening statement?

Mr. ROHRABACHER. Very short, Mr. Chairman.

I am going to be listening intently to this hearing and especially about what is going on with Vanuatu. I have firsthand knowledge of Vanuatu. And let me notice—

Mr. FALEOMAVAEGA. Does the gentleman yield? I think there are only two of us on this whole committee that knows where Vanuatu is.

Mr. ROHRABACHER. I think that is probably correct.

I have not been a fan of foreign aid over the years, and the Millennium Challenge Account has been at least a reasonable attempt to try to set standards so that money that we use will in some way be put to good use, where other times I have seen—over the 30 years that I have been in Washington, I have seen money provided that has absolutely no results that you can see at all.

And I notice that the people are suggesting that our aid to Vanuatu doesn't impact the ordinary people, but impacts the tourist industry and the transportation industry, but, in fact, in Vanuatu, from what I—if my memory serves me correct, we are talking about a major part of their economy, which is transportation and tourism. So I would be very interested in hearing the testimony today.

I think it is important for us not just to hand over money to people for which really does go into a black hole, but to set standards. And I would like to see what the Millennium Challenge Account is doing in terms of Vanuatu. And I think it is a very interesting case study. So I would be happy to listen today.

Thank you for your leadership, Mr. Chairman.

Mr. FALEOMAVAEGA. I thank the gentleman for his statement.

I think one of the frustrations that we have also borne over the years is criticism not only from the America public, the taxpayers, and the fact that sometimes we give foreign assistance to some countries very unstable, controlled by dictators, and they are the same ones that turn around and spit in our face. I think this is a procedure where we are trying to make sure that the countries are poverty-stricken, countries that have real needs. Then we have measurements for making sure money is properly spent. And I think this is what we are looking at conceptually as the basis of not only providing this kind of legislation, but giving those in charge in implementing the compacts or the provisions of this law that we have passed a couple of years ago, and hopefully that it will become a positive situation for our country.

We have two excellent witnesses this afternoon, both gentlemen very prominent. And I must say on behalf of the committee, I want to commend both of you gentlemen for the services that you have rendered to our country and the capacities that you currently serve in the administration.

Our first witness is a Dr. David Gootnick, who is a medical doctor by profession and is currently serving as the Director of the International Affairs and Trade Division of the U.S. General Accounting Office. He has served in this capacity now for the past 6 years; was formerly the Director of Medical Services of the Peace Corps, still part of his responsibility with his medical background. He also served as director of the university health services at New York University, a graduate of Harvard University, and received his medical degree from the University of Rochester in New York,

and has been responsible for about 1,000 GAO reports that I have listed.

Dr. Gootnick, I really, really appreciate your taking the time to come and share the results of your findings on this GAO report.

The gentleman representing the Millennium Challenge Corporation is Mr. Rodney Bent, Deputy Chief Executive Officer. Mr. Bent is currently Deputy CEO. He is an officer of the Corporation that manages the day-to-day operations of the agency. Mr. Bent previously served as MCC's Vice President for Policy and International Relations.

Mr. Bent has spent over 20 years in the Office of Management and Budget, so he does know something about budgeting and divvying up funding in that respect. He also held positions at the Bankers Trust Company and with the Department of Treasury; and received a degree from Cornell University, a master's from the Fletcher School of Law; served also many years as a professional staff member of the House Appropriations Committee, where he recommended appropriations levels and policies for the USAID programs as well as the Export-Import Bank, the Overseas Private Investment Corporation and the U.S. Trade and Development Agency. And that is a mouthful.

And I am quite certain that both gentlemen will give us their professional judgments on this important issue that we are now considering this afternoon.

So I would like to turn the time over now to Dr. Gootnick for his statement.

STATEMENT OF DAVID B. GOOTNICK, M.D., DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Dr. GOOTNICK. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am pleased to discuss GAO's analysis, released today, of the MCC compact in Vanuatu. As you have well and thoroughly stated, Mr. Chairman, in March 2006, MCC established a 5-year, \$66 million compact with Vanuatu, its only compact in the Pacific. At \$317 per capita, this is by far MCC's largest compact on a per capita basis.

Today I will briefly discuss two issues; first, MCC's analysis and portrayal of the compact's projected benefits, and, second, risks that would affect the compact's projected results.

Regarding projected benefits, MCC analyzed Vanuatu's proposal to repair and improve roads, bridges and other infrastructure. They then projected benefits from improved transportation, construction spending and the growth of tourism and agriculture. MCC states that the compact will have a transformational impact on Vanuatu's economic development.

MCC's due diligence was generally sound; however, its portrayal of compact benefits does not accurately reflect its own underlying analysis and suggests impacts far greater than its own data support. The clearest example of this problem is MCC's portrayal of projected per capita income. MCC states that as a result of the compact, per capita income will increase by 15 percent, or \$200, by 2010 and 37 percent, or \$488, by 2015. However, as the poster here on my right illustrates, MCC's underlying data show that these fig-

ures represent the sum of yearly gains in per capita income rather than actual gains. This poster is also figure 5 in my full statement.

MCC actually projects income gains of \$51 per person in 2022, not the \$200 they have put in all public documents. The underlying data and analysis are not publicly available, have not been presented to Congress or other interested parties.

MCC has also stated that the compact will result in a 3 percent increase in GDP each year; however, its underlying data project a one-time 3 percent rise in GDP, with the growth rate remaining essentially at the baseline after 2007.

MCC also states that the compact is expected to benefit approximately 65,000 poor rural individuals, but does not indicate the proportion of total compact benefits that will accrue to the rural poor. I don't want to suggest, as has been implied, that the percentage of benefits going to the business and the entrepreneurial sector is inappropriate or wrong-headed in any way. Rather the issue is the disclosure and the explanation of benefits that will accrue, and to whom.

Finally, we identified five key risks that could affect the compact's results. First, MCC's construction cost and its estimates may not be sufficient. Second, projected benefits will likely accrue more slowly than MCC projects. Third, infrastructure maintenance is not fully developed as a risk. Fourth, projected growth in tourism and agriculture may be overly optimistic. Fifth, time saved in transit on improved roads is a social good, but may not result in measurable economic activity as MCC expects. Accounting for these risks, the compact benefits may be well below MCC's projections.

In summary, Mr. Chairman, we are concerned about the gap between MCC's public statements about compact benefits and its underlying data and analysis. MCC's portrayal, for example, of per capita GDP can be understood only by analyzing its rather detailed analysis supporting source documents and spreadsheets which are not publicly available. This is not a semantic discussion. This is an issue of transparency and ultimately of MCC's credibility. These gaps could lead to unrealistic expectations within Vanuatu and among other interested parties.

MCC also takes a risk in suggesting that its compact will achieve sustainable growth in Vanuatu at a level no other donor has every achieved. Further, these gaps raise questions about other compact projections of transformative impacts. Accurate representation of its compact projected benefits will be key to MCC's credibility in the future years.

We are recommending that MCC fix its public reporting of the Vanuatu compact, determine if similar statements have been made in other compacts, and refine its analysis to more fully account for project risks. In response, MCC has characterized its own portrayal as misleading, but stated, (1) that it had no intention to mislead, and (2) its portrayal was factually correct and consistent with the underlying data.

Regarding the former, we did not determine how this gap was created, but I do not in any way want to imply that MCC intended to mislead. Nothing in my experience to date with MCC would suggest that these statements were misleading in an intentional way.

However, on a latter point, MCC's portrayal can be considered accurate and transparent only if Congress, people of Vanuatu and other interested parties were to know that it represents, for example, cumulative income and growth over 5 years. However, MCC's public statement today would lead an observer to just the opposite conclusion.

Mr. Chairman, this concludes my remarks. I am happy to answer any of your questions.

[The prepared statement of Dr. Gootnick follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Asia, the Pacific,
and the Global Environment, Committee on
Foreign Affairs, House of Representatives

For Release on Delivery Expected
at 2 p.m. EDT
Thursday, July 26, 2007

**MILLENNIUM
CHALLENGE
CORPORATION**

**Projected Impact of Vanuatu
Compact Is Overstated**

Statement of David B. Gootnick, Director
International Affairs and Trade



Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss our recent work regarding the Millennium Challenge Corporation's (MCC) compact with Vanuatu.¹

In January 2004, Congress established MCC to administer the Millennium Challenge Account for foreign assistance. MCC's mission is to reduce poverty by supporting sustainable, transformative economic growth in developing countries that have demonstrated a commitment to ruling justly and democratically, encouraging economic freedom, and investing in people. Congress appropriated almost \$6 billion to MCC for fiscal years 2004 through 2007, and the President has requested an additional \$3 billion in MCC funding for fiscal year 2008. As of March 2007, MCC had signed 11 compacts totaling approximately \$3 billion.² MCC's 5-year, \$65.7 million compact with Vanuatu focuses on increasing economic activity and incomes in rural areas through investments in transportation infrastructure. Although MCC's Vanuatu compact is its smallest compact monetarily, it provides by far the largest amount relative to the country's population and gross domestic product (GDP).³

Publicly available documents show that MCC expects its compacts to significantly benefit the countries' economies. In its Vanuatu compact and its March 2006 congressional notification, MCC states that it expects the compact to have a "transformational" impact—that is, as MCC defines it, "a dramatic and long-lasting impact on poverty reduction through sustainable economic growth."⁴ Using its projected benefit and cost data, MCC calculated of the compact's expected economic rate of return (ERR)⁵ and impact on poverty reduction and

¹GAO, *Millennium Challenge Corporation: Vanuatu Compact Overstates Projected Program Impact*, GAO-07-909 (Washington, D.C.: July 2007).

²An MCC compact is an agreement between the U.S. government, acting through MCC, and the government of a country eligible for MCA assistance. In June 2007, the MCC board approved a \$362.6 million compact with Lesotho and a \$506.9 million compact with Mozambique.

³MCC's \$65.7 million compact with Vanuatu provides \$317 per capita; in contrast, MCC's \$547 million compact with Ghana—its largest compact—provides \$25 per capita. The amounts provided per capita by the 11 compacts signed to date range from \$6 for Madagascar to \$317 for Vanuatu.

⁴Millennium Challenge Account, *Best Practices in Compact Development* (Washington, D.C.: 2006).

⁵Project cash flows are determined by comparing program spending against future expected increases in value added or income. The internal rate of return is calculated for these cash flows to summarize the economic impact. MCC refers to this internal rate of return as the economic rate of return.

economic growth. MCC states that its compacts will provide or contribute to a transformational impact in 5 of its 11 compacts.⁶

In my testimony today, I will address (1) MCC's methods of projecting and calculating the Vanuatu compact's impact on poverty reduction and economic growth, (2) MCC's portrayal and analysis of the Vanuatu compact's projected impact, and (3) risks that could affect the Vanuatu compact's actual impact. This statement summarizes the findings in our report released today.

In our report, we addressed our first and second objectives by evaluating MCC's economic analysis of the Vanuatu compact proposal and MCC's public statements about the compact's impacts. We could not validate most of MCC's underlying data and assumptions, because the data were not available or could not be checked within the time frames of our engagement. To address our third objective, we identified risks to MCC's compact results, based on our review of MCC's internal documentation, donor reporting, and academic literature. To illustrate the impact of these risks on MCC's economic analyses of ERR, GDP, and per capita income, we modeled the risks using the data from MCC's economic analyses; however, we did not validate these data. We focused our analysis and field work on MCC's three transportation infrastructure projects on Vanuatu's two most populous islands, Santo and Efate, which represent 56 percent of compact cost. We interviewed Vanuatu and MCC officials and interested parties such as tourism and agriculture business owners and contacted MCC's contractor. We conducted this work from August 2006 through May 2007 in accordance with generally accepted government auditing standards.

Summary

MCC projected the Vanuatu compact's impact by estimating the program's benefits, costs, and beneficiaries and calculating the compact's effect on per capita income, GDP, and poverty reduction. According to MCC, transportation infrastructure improvements will provide direct benefits, such as construction spending in the local economy, reduced transportation costs, and improved services, as well as induced benefits from growth in Vanuatu's tourism and agriculture sectors. MCC estimated the value of these benefits over a 20-year period, beginning in full in 2008 or 2009 and growing each year. MCC developed its project cost estimates based on existing cost estimates prepared for

⁶For example, in Nicaragua, MCC expects that the compact will transform project areas into an engine of economic growth; in El Salvador, MCC states that the compact provides an historic opportunity to transform the country's economic development; and in Armenia, MCC is undertaking road and irrigation projects to transform the economic performance of Armenia's agricultural sector.

the government of Vanuatu and for another donor. To determine the number of poor, rural beneficiaries, MCC defined a catchment area—the geographic area in which benefits may be expected to accrue—using maps of Vanuatu and data from the most recent Vanuatu census. Using its projected benefit and cost data, MCC calculated the compact’s ERR by comparing projected benefits with projected costs; calculated the compact’s impact on per capita income by determining the total benefits and dividing the total value by Vanuatu’s baseline population; and calculated the compact’s impact on Vanuatu’s GDP by computing the total benefits added to the economy.

In the compact and the congressional notification, MCC portrays projected impacts on per capita income and GDP that do not reflect the underlying data and analysis, which are not publicly available. Also, MCC does not establish the proportion of monetary benefits that will accrue to the rural poor.

Per capita income. MCC states that as a result of the compact, per capita income will increase by approximately \$200, or 15 percent, by 2010 and \$488, or 37 percent, by 2015. This statement suggests that per capita income in 2010 and 2015 will be, respectively, 15 percent and 37 percent higher than without the compact. However, MCC’s data show that these percentages represent sums of per capita income gains for individual years. The actual gains in per capita income, relative to income in 2005, would be \$51, or 3.9 percent, in 2010 and \$61, or 4.6 percent, in 2015.

GDP. MCC states that Vanuatu’s GDP will increase by “an additional 3 percent a year.” However, MCC’s underlying data and calculations show that although the level of Vanuatu’s GDP will grow by 6 percent in 2007, the economy’s growth rate in subsequent years will continue at approximately 3 percent, the growth rate that MCC assumes would occur without the compact.

Poverty reduction. MCC states that the compact is expected to benefit approximately 65,000 poor, rural inhabitants “living nearby and using the roads to access markets and social services.” According to MCC’s underlying documentation, 57 percent of the compact’s monetary benefits will accrue to tourism services providers, transport providers, government workers, and local businesses and 43 percent of the benefits will go to the local population—that is, local producers, local consumers, and inhabitants of remote communities. However, MCC does not establish the proportion of local-population benefits that will go to the rural poor.

Our analysis shows five key areas of risk that may affect the Vanuatu compact’s actual impact on poverty reduction and economic growth.

Construction costs. The contingencies included in MCC's calculations of construction costs may not be sufficient to cover potential cost overruns. The risk of excessive cost overruns is especially significant in a small country such as Vanuatu. Any construction cost overrun could cause MCC to reduce the compact's scope and therefore its benefits.

Timing of benefits. Although MCC projects that the compact's benefits will begin shortly after completion of the projects, some benefits are likely to accrue more slowly. For example, according to agricultural and timber producers, their businesses will likely respond gradually to any increased market opportunities.

Project maintenance. MCC's benefit projections assume continued maintenance of completed projects; however, its ability to ensure such maintenance will end in 2011. Moreover, previous donors to Vanuatu have found the country's maintenance of donor projects to be poor. Reduced maintenance would lead to reduced benefits from the project.

Induced benefits. MCC projects that induced benefits from Vanuatu's tourism and agriculture—for example, increased tourist traffic and agricultural trade—will lead to expansion of these economic sectors. However, realization of such benefits depends on businesses' and rural inhabitants' responses to opportunities created by the compact's infrastructure improvements.

Efficiency gains. MCC's projections count efficiency gains from the infrastructure improvements, such as time saved in transit, as direct benefits. However, such gains may not be put to economic use or result in increased per capita income as MCC projects. Accounting for these risks could reduce overall compact ERR from 24.2 percent, as projected by MCC, to between 5.5 percent and 16.5 percent.⁷

To help MCC better express and determine the impact of its compacts, our report recommends that MCC's Chief Executive Officer (CEO) (1) revise the public reporting of the projected impact of the Vanuatu compact, (2) assess whether similar statements in other compacts accurately reflect underlying data, and (3) improve MCC's economic analysis by phasing costs and benefits and more fully accounting for risks to project benefits. In comments on a draft of our report, MCC responded that it had not intended to make misleading statements and that its portrayal of projected results was factual and consistent with underlying data.

⁷MCC expresses the compact's ERR—the ratio of its benefits and costs—as a percentage.

Background

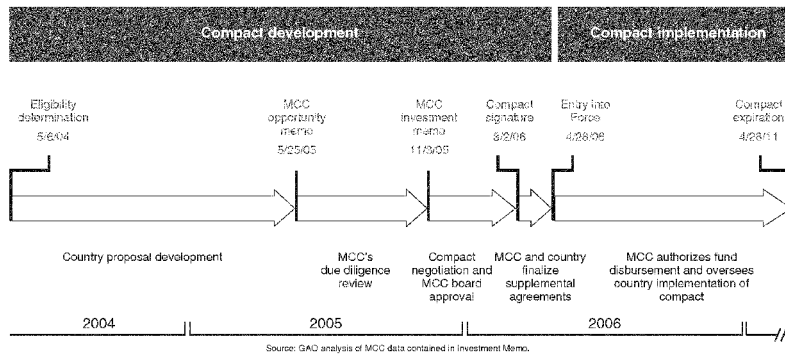
Vanuatu consists of 83 islands spread over hundreds of miles of ocean in the South Pacific, 1,300 miles northeast of Sydney, Australia. About 39 percent of the population is concentrated on the islands of Santo and Efate. Vanuatu's capital, Port Vila, is on Efate, and Vanuatu's only other urban center, Luganville, is on Santo.

In the past decade, Vanuatu's real GDP growth averaged 2 percent, although more rapid population growth led to a decline in per capita GDP over the same period. Average growth of real GDP per capita was negative from 1993 to 2005. An estimated 40 percent of Vanuatu's population of about 207,000 has an income below the international poverty line of \$1 per day. Agriculture and tourism are the principal productive sectors of Vanuatu's economy, contributing approximately 15 percent and 19 percent to GDP, respectively. Although agriculture represents a relatively small share of Vanuatu's overall economy, approximately 80 percent of Vanuatu's residents live in rural areas and depend on subsistence agriculture for food and shelter. The tourism sector is dominated by expatriates of foreign countries living in Vanuatu, who also predominate in other formal sectors of the economy such as plantation agriculture and retail trade.

On May 6, 2004, MCC determined that Vanuatu was eligible to submit a compact proposal for Millennium Challenge Account funding.⁸ Vanuatu's proposal identified transportation infrastructure as a key constraint to private-sector development. The timeline in figure 1 shows the development and implementation of the Vanuatu proposal and compact.

⁸The Millennium Challenge Act of 2003 requires MCC to determine whether countries are eligible for MCA assistance each fiscal year. Countries with per capita income at or below a set threshold may be selected as eligible for assistance if they meet MCC indicator criteria and are not statutorily barred from receiving U.S. assistance. MCC uses 16 indicators divided into three categories: Ruling Justly, Encouraging Economic Freedom, and Investing in People. To be eligible for MCA assistance, countries must score above the median relative to their peers on at least half of the indicators in each category and above the median on the indicator for combating corruption. GAO, *Millennium Challenge Corporation: Compact Implementation Structures Are Being Established; Framework for Measuring Results Needs Improvement*, GAO-06-805 (Washington, D.C.: July 28, 2006).

Figure 1: Development and Implementation of Vanuatu Compact

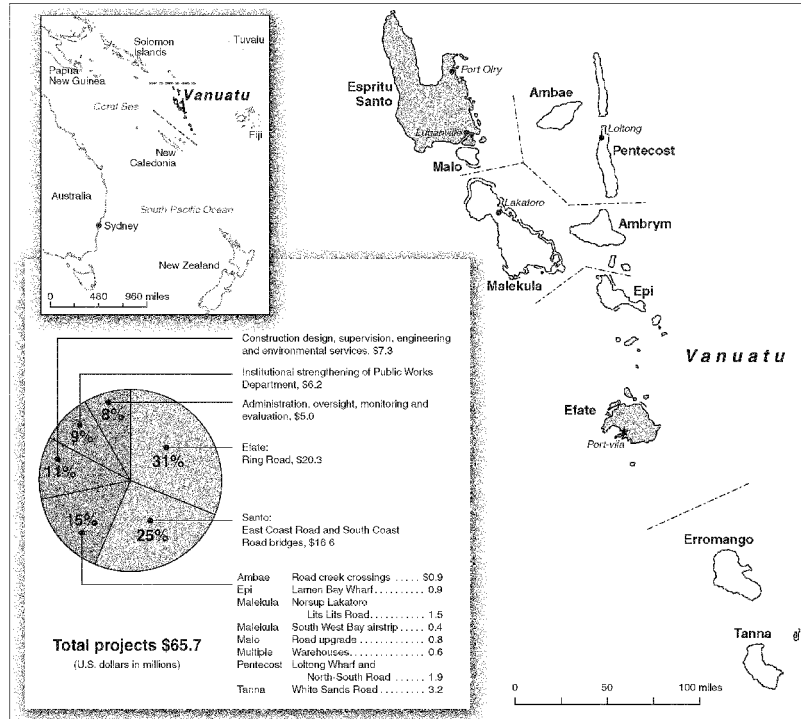


The \$65.7 million Vanuatu compact includes \$54.5 million for the rehabilitation or construction of 11 transportation infrastructure assets on 8 of Vanuatu's 83 islands, including roads, wharves, an airstrip, and warehouses (see fig. 2). The compact also includes \$6.2 million for an institutional strengthening program to increase the capacity of the Vanuatu Public Works Department (PWD) to maintain transportation infrastructure.⁹ The remaining \$5 million is for program management and monitoring and evaluation. More than half of the compact, \$37 million, is budgeted for three road projects on Santo and Efate islands. The compact provides for upgrading existing roads on both islands; the compact also includes five new bridges for an existing road on Santo.¹⁰

⁹The institutional strengthening program includes \$5.74 million for equipment purchases; of this amount, \$1.4 million is provided directly to PWD and the remainder will purchase equipment for the use of the MCC construction contractor, to be turned over to the PWD in specified condition 4 years later.

¹⁰As of March 2007, MCC had disbursed \$1.72 million in compact funds, or about 16 percent of planned disbursements by that date.

Figure 2: MCC Vanuatu Projects by Size and Location



Sources: GAO based on MCC data; Miro Resources (map).

MCC's compact with Vanuatu and congressional notification state that the compact will have a transformational impact on Vanuatu's economic development, increasing average per capita income by approximately \$200—15 percent—by 2010 and increasing total GDP by “an additional 3 percent a year.” MCC's investment memo further quantifies the per capita income increase as \$488—37 percent—by 2015.¹¹ The compact and the congressional notification also state that the compact will provide benefits to approximately 65,000 poor, rural inhabitants (see fig. 3).

Figure 3: MCC Statement of Impacts in March 2006 Congressional Notification

“The Transport Infrastructure Project is expected to have a transformational impact on Vanuatu's economic development, increasing average income per capita (in real terms) by approximately \$200, or 15 percent of current income per capita, by 2010. GDP is expected to increase by an additional 3 percent a year, as a result of the program.

Based on the areas covered by the transport assets, the program can be expected to benefit approximately 65,000 poor, rural inhabitants living nearby and using the roads to access markets and social services.”

Source: MCC Congressional Notification, March 2006.

MCC Projected Compact's Impact Using Estimates of Benefits, Costs, and Catchment Area

In projecting the impact of the Vanuatu compact, MCC estimated the benefits and costs of the proposed infrastructure improvements. MCC also estimated the number of beneficiaries within a defined catchment area—that is, the geographic area in which benefits may be expected to accrue. MCC used the estimated benefits and costs to calculate the compact's ERR and impact on Vanuatu's GDP and per capita income.

MCC's analysis determined that the compact will reduce transportation costs and improve the reliability of access to transportation services for poor, rural agricultural producers and providers of tourism-related goods and services and that these benefits will, in turn, lead to increases in per capita income and GDP and reduction in poverty. MCC projects several direct and induced benefits from the compact's infrastructure improvement projects over a 20-year period, beginning in full in 2008 or 2009 and increasing by at least 3 percent every year.

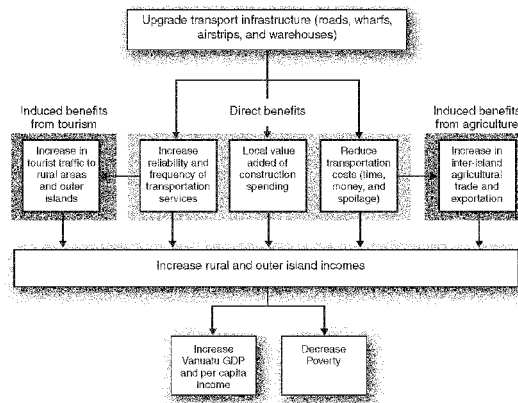
¹¹The “investment memo” is an MCC internal document prepared by MCC's compact assessment team and submitted to MCC's investment committee—consisting of MCC's Chief Executive Officer (CEO), vice presidents, and other senior officials. The committee reviews the memo and decides whether to recommend proceeding to compact negotiations.

Direct benefits. MCC projects that direct benefits will include, for example, construction spending, reduced transportation costs, and time saved in transit on the improved roads.

Induced benefits. MCC projects that induced benefits from tourism and agriculture will include, for example, increased growth in Vanuatu tourism, tourist spending, and hotel occupancy and increased crop, livestock, and fisheries production.

Figure 4 illustrates MCC’s logic in projecting the compact’s impact.

Figure 4: MCC’s Logic Model for the Vanuatu Compact



Source: MCC, with GAO analysis.

MCC expects compact benefits to flow from different sources, depending on the project and its location. In Efate, the Ring Road is expected to provide direct benefits from decreased road user costs and induced benefits through tourism and foreign resident spending. In Santo, MCC anticipates similar benefits as well as the induced benefit of increased agricultural production. On other islands, where

tourism is not as developed, MCC expects benefits to derive primarily from user cost savings and increased agriculture.¹²

To calculate construction and maintenance costs¹³ for the transportation infrastructure projects, MCC used existing cost estimates prepared for the government of Vanuatu¹⁴ and for another donor as well as data from the Vanuatu PWD.

To estimate the number of poor, rural beneficiaries, MCC used Vanuatu maps to identify villages in the catchment area and used the 1999 Vanuatu National Population and Housing Census to determine the number of persons living in those villages. In all, MCC calculated that approximately 65,000 poor, rural people on the eight islands would benefit from MCC projects.

On the basis of the costs and benefits projected over a 20-year period, MCC calculated three summaries of the compact's impact: its ERR, effect on per capita income, and effect on GDP. MCC projected an overall compact ERR of 24.7 percent over 20 years.¹⁵ In projecting the compact's impact on Vanuatu's per capita income, MCC used a baseline per capita income of \$1,326 for 2005.

MCC also prepared a sensitivity analysis to assess how a range of possible outcomes would affect compact results. MCC's tests included a 1-year delay of the start date for accrued benefits; a 20 percent increase of all costs; a 20 percent decrease of all benefits; and a "stress test," with a 20 percent increase of all costs and a 20 percent decrease of all benefits. MCC calculated a best-case compact ERR of 30.2 percent and a worst-case compact ERR of 13.9 percent.

¹²Benefits other than those included in its economic analysis may accrue to Vanuatu as a result of the compact. For example, increased economic activity in tourism may benefit other sectors of the economy and that the welfare of Vanuatu's citizens may improve with increased access to health care and educational opportunities.

¹³MCC's economic model assumes that construction costs are incurred in the first year after compact signing and counts 16 percent of total construction spending as a benefit to the local economy for that year.

¹⁴MCC's cost estimate for construction and maintenance of the projects on Santo and Efate was based on an estimate prepared for the Vanuatu government by a contractor in 2004. We asked MCC for a copy of the 2004 estimate; however, according to MCC officials, MCC did not have a copy and the government was not willing to provide the estimate for our review.

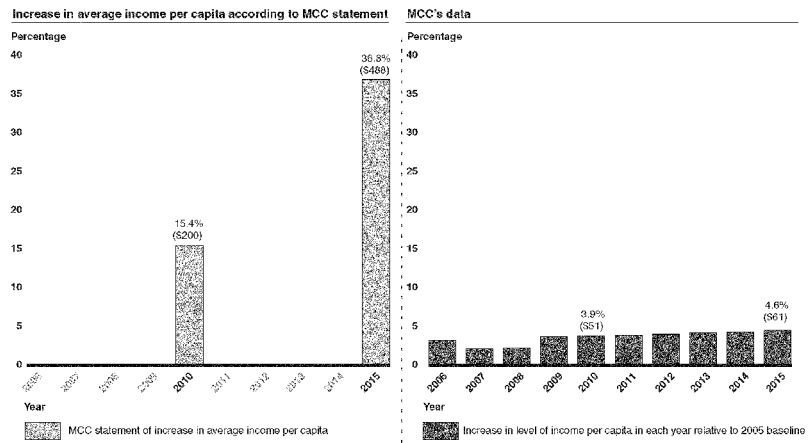
¹⁵In its final April 2006 economic analysis, MCC adjusted this calculation downward slightly to 24.2 percent.

MCC's Data Do Not Support Its Portrayal of Compact Benefits

MCC's public portrayal of the Vanuatu compact's projected effects on per capita income and on GDP suggest greater impact than its analysis supports. In addition, MCC's portrayal of the compact's projected impact on poverty does not identify the proportion of benefits that will accrue to the rural poor.

Impact on per capita income. In the compact and the congressional notification, MCC states that the transportation infrastructure project is expected to increase "average income per capita (in real terms) by approximately \$200, or 15 percent of current income per capita, by 2010." MCC's investment memo states that the compact will cause per capita income to increase by \$488, or 37 percent, by 2015. These statements suggest that as a result of the program, average incomes in Vanuatu will be 15 percent higher in 2010 and 37 percent higher in 2015 than they would be without the compact. However, MCC's underlying data show that these percentages represent the sum of increases from per capita income in 2005 that MCC projects for each year. For example, according to MCC's data, Vanuatu's per capita income in a given year between 2006 and 2010 will range from about 2 percent to almost 4 percent higher than in 2005; in its statements, MCC sums these percentages as 15 percent without stating that this percentage is a cumulative increase from 2005. Our analysis of MCC's data shows that actual gains in per capita income, relative to income in 2005, would be \$51, or 3.9 percent, in 2010 and \$61, or 4.6 percent, in 2015 (see fig. 5).

Figure 5: Vanuatu Compact's Projected Impact on Real Per Capita Income According to MCC Statement and MCC Data Relative to 2005 Per Capita Income

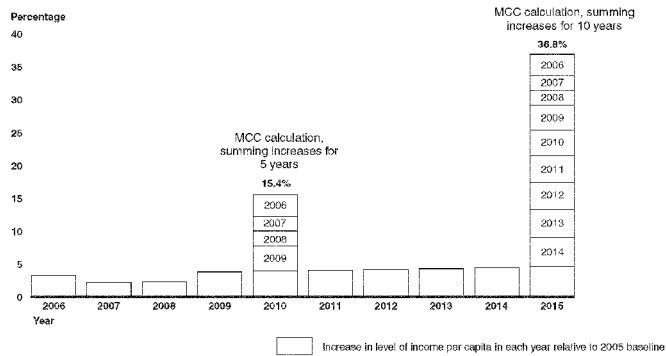


Source: GAO analysis of MCC data contained in Investment Memo.

Note: MCC's statement: "Increasing average income per capita (in real terms) by approximately \$200 or 15 percent of current income per capita by 2010" and by \$488—37 percent—by 2015.

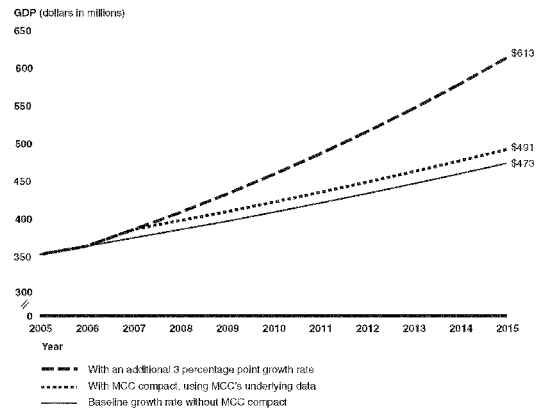
Figure 6 further illustrates MCC's methodology in projecting the compact's impact on per capita income levels for 2010 and 2015.

Figure 6: MCC Methodology for Projecting Vanuatu Compact's Impact on Real Per Capita Income



Impact on GDP. Like its portrayal of the projected impact on per capita income, MCC's portrayal of the projected impact on GDP is not supported by the underlying data. In the compact and the 2006 congressional notification, MCC states that the compact will have a transformational effect on Vanuatu's economy, causing GDP to "increase by an additional 3 percent a year." Given the GDP growth rate of about 3 percent that MCC expects in Vanuatu without the compact, MCC's statement of a transformational effect suggests that the GDP growth rate will rise to about 6 percent. However, MCC's underlying data show that although Vanuatu's GDP growth rate will rise to about 6 percent in 2007, in subsequent years the GDP growth rate will revert to roughly the rate MCC assumes would occur without the compact, approximately 3 percent (see fig. 7). Although MCC's data show that the compact will result in a higher level (i.e., dollar value) of GDP, the data do not show a transformational increase to the GDP growth rate.

Figure 7: Vanuatu GDP Growth with and without MCC Compact



Source: GAO analysis of MCC data.

Notes:

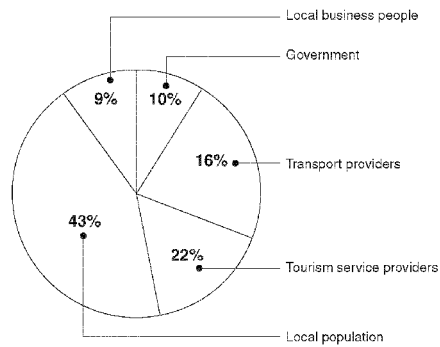
According to MCC, "GDP is expected to increase by an additional 3 percent a year as a result of the MCA program."

According to MCC data, the compact will have a small impact on GDP growth rate in later years. In 2010 to 2015, the GDP growth rate resulting from the compact will be 3.1 percent, compared with 3 percent without the compact.

Impact on poverty. MCC's portrayal of the compact's projected impact on poverty does not identify the proportion of the financial benefits that will accrue to the rural poor. In the compact and the congressional notification, MCC states that the program is expected to benefit "approximately 65,000 poor, rural inhabitants living nearby and using the roads to access markets and social services." In its underlying documentation, MCC expects 57 percent of the monetary benefits to accrue to other beneficiaries, including expatriate tourism services providers, transport providers, government, and local businesses; 43 percent is expected to go to the local population, which MCC defines as "local producers, local consumers and inhabitants of remote communities" (see fig. 8).

However, MCC does not establish the proportion of local-population benefits that will go to the 65,000 poor, rural beneficiaries.¹⁶

Figure 8: MCC Analysis of Distribution of Vanuatu Compact Benefits



Source: MCC analysis.
 Note: MCC defines "local population" as comprising local producers, local consumers, and inhabitants of rural communities.

Several Risks May Lead to Reduced Project Benefits

Our analysis shows that risks related to construction costs, timing of benefits, project maintenance, induced benefits, and efficiency gains may lessen the Vanuatu compact's projected impact on poverty reduction and economic growth. Accounting for these risks could reduce the overall compact ERR.

¹⁶Our review of MCC's analyses also identified some calculation errors in MCC's determination of the compact's impact on per capita income and estimation of the number of compact beneficiaries. In addition, we identified questionable assumptions regarding the beneficiary population. For example, MCC counted all residents of the catchment area as poor and assumed that residents of off-shore islets and villages near paved portions of the Elite Ring Road not improved by MCC would benefit from the compact. Correcting these errors and fully discounting these assumptions would reduce the beneficiary count on Efate and Santo by 32 percent—from 26,553, as stated by MCC, to 18,070—indicating that MCC may have overestimated the compact's beneficiaries.

Construction costs. Although MCC considered the risk of construction cost increases, the contingencies used in its calculations may not be sufficient to cover actual construction costs. Cost estimate documentation for 5 of MCC's 11 construction projects shows that these estimates include design contingencies of 20 percent. However, cost overruns of more than 20 percent occur in many transportation projects,¹⁷ and as MCC's analysis notes, the risk of excessive cost overruns is significant in a small country such as Vanuatu.¹⁸ Any construction cost overrun must be made up within the Vanuatu compact budget by reducing the scope, and therefore the benefits, of the compact projects;¹⁹ reduced project benefits would in turn reduce the compact's ERR and effects on per capita income and GDP.

Timing of benefits. Although MCC's analysis assumes compact benefits from 2008 or 2009—shortly after the end of project construction—we found that benefits are likely to accrue more slowly. Our document review and discussions with tourism services providers and agricultural and timber producers suggest that these businesses will likely react gradually to any increased market opportunities resulting from MCC's projects, in part because of constraints to expanding economic activity.²⁰ In addition, MCC assumes that all construction spending will occur in the first year, instead of phasing the benefits from this spending over the multiyear construction schedule.

¹⁷A study of more than 250 transportation projects in Europe, North America, and elsewhere found that costs for all projects were 28 percent higher, on average, than forecasted at the time of decision to build, while road projects averaged escalations of 20.4 percent. See Bent Flyvbjerg, Mette Skamris Holm, and Soren Buhl, "Underestimating Costs in Public Works Projects: Error or Lie?," *Journal of the American Planning Association*, Vol. 68, No. 3 (2002), cited in GAO, *Highway and Transit Investments: Options for Improving Information on Projects' Benefits and Costs and Increasing Accountability for Results*, GAO-05-172 (Washington, D.C.: January 24, 2005).

¹⁸MCC cites the "design-construct" contract proposed for the MCA program, which will include design and construction of all the projects as one package, as key to mitigating this risk. However, MCC's analysis also recognized that nonconstruction-related issues (such as access to parts of the project site) have the potential to delay the contractor and increase costs and that such issues can be significant for major road upgrade projects where the competing interests of the contractor, adjacent villages, and the general public must be balanced. MCC's analysis states that, to help manage the risk of project-related disputes and delays, MCC plans to have experienced consultants work with local PWD staff who have an understanding of the social and cultural issues.

¹⁹According to the compact, the government of Vanuatu must pay any environmental mitigation and remediation costs in excess of the budget.

²⁰Benefits from construction activities may also be reduced by a delayed procurement. MCA-Vanuatu officials initially told us they anticipated issuing an invitation for bid to contractors by the end of February 2007. As of May 2007, the invitation had not yet been issued. MCC currently expects construction to begin in 2008, further reducing the likelihood of benefits starting in 2007 as MCC anticipated in its analyses.

Project maintenance. Uncertainty about the maintenance of completed transportation infrastructure projects after 2011 may affect the compact's projected benefits. Vanuatu's record of road maintenance is poor. According to World Bank and Asian Development Bank officials, continuing donor involvement is needed to ensure the maintenance and sustainability of completed projects. However, although MCC has budgeted \$6.2 million for institutional strengthening of the Vanuatu PWD, MCC has no means of ensuring the maintenance of completed projects after the compact expires in 2011; the Millennium Challenge Act limits compacts to 5 years. Poor maintenance performance will reduce the benefits projected in the MCC compact.

Induced benefits. The compact's induced benefits depend on the response of Vanuatu tourism providers and agricultural producers. However, constraints affecting these economic sectors may prevent the sector from expanding as MCC projects. Limited response to the compact by tourism providers and agricultural producers would have a significant impact on compact benefits.

Efficiency gains. MCC counts efficiency gains—such as time saved because of better roads—as compact benefits. However, although efficiency gains could improve social welfare, they may not lead to changes in per capita income or GDP or be directly measurable as net additions to the economy.

Accounting for these risks could reduce the overall compact ERR from 24.2 percent, as projected by MCC, to between 5.5 percent and 16.5 percent (see table 1).

Table 1: Summary of Compact ERR under Alternative Scenarios of Accounting for Risks to Benefits

	Compact ERR
MCC's anticipated effect	24.2 percent
GAO analysis^a	
(1) Costs are phased over 3 years and benefits are phased over 5 years	16.5 percent
Costs are phased over 3 years and benefits are phased over 5 years, and	
(2) induced benefits are not realized ^b	5.5 percent
(3) efficiency gains are not monetized ^c	11.8 percent
(4) large-scale maintenance is not undertaken ^d	13.8 percent

Source: GAO analysis of MCC data.

^aIn our analysis, benefits start in 2010 and are phased in equal increments over 5 years, from 2010 to 2014, with phasing completed by year 5. Costs are phased over 3 years to reflect projected timing of construction.

^bIn addition to phasing benefits and costs, we eliminated induced effects of the project on agriculture, tourism, fisheries, and the development of subdivided beachfront land.

^cIn addition to phasing benefits and costs, we eliminated road user cost savings and savings from reduction of wasted surface trips, lost trips, longer diversions, and enforced longer trips from road closures.

^dIn addition to phasing benefits and costs, we assumed that total benefits will increase, peak, and decrease such that their value in 2027 will equal their original value in 2012. The large capital outlays for road rehabilitation in 2017 and 2026 in Santo and Efate have been eliminated.

Conclusions

MCC's public portrayal of the Vanuatu compact's projected benefits—particularly the effect on per capita income—suggests a greater impact than MCC's underlying data and analysis support and can be understood only by reviewing source documents and spreadsheets that are not publicly available. As a result, MCC's statements may foster unrealistic expectations of the compact's impact in Vanuatu. For example, by suggesting that per capita incomes will increase so quickly, MCC suggests that its compact will produce sustainable growth that other donors to Vanuatu have not been able to achieve. The gaps between MCC's statements about, and underlying analysis of, the Vanuatu compact also raise questions about other MCC compacts' projections of a transformational impact on country economies or economic sectors. Without accurate portrayals of its compacts' projected benefits, the extent to which MCC's compacts are likely to further its goals of poverty reduction and economic growth cannot be accurately evaluated. In addition, the economic analysis underlying MCC's statements does not reflect the time required to improve Vanuatu's transportation infrastructure and for the economy to respond

and does not fully account for other risks that could substantially reduce compact benefits.

Recommendations

In our report, we recommend that the CEO of MCC take the following actions:

revise the public reporting of the Vanuatu compact's projected impact to clearly represent the underlying data and analysis;

assess whether similar statements in other compacts accurately reflect the underlying data and analysis; and

improve its economic analysis by phasing the costs and benefits in compact ERR calculations and by more fully accounting for risks such as those related to continuing maintenance, induced benefits, and monetized efficiency gains as part of sensitivity analysis.

In comments on a draft of our report, MCC did not directly acknowledge our recommendations. MCC acknowledged that its use of projected cumulative compact impact on income and growth was misleading but asserted that it had no intention to mislead and that its portrayal of projected compact benefits was factually correct. MCC questioned our finding that its underlying data and analysis do not support its portrayal of compact benefits and our characterization of the program's risks. (See app. VI of our report for MCC comments and our response.²¹)

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Subcommittee may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this testimony, please contact me at (202) 512-3149 or gootnickd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. In addition to the person named above, Emil Friberg, Jr. (Assistant Director), Gergana Danailova-Trainor, Reid Lowe, Angie Nichols-Friedman, Michael Simon, and Seyda Wentworth made key

²¹GAO-07-909.

contributions to this statement. Also, David Dornisch, Etana Finkler, Ernie Jackson, and Tom McCool provided technical assistance.

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Mr. FALEOMAVAEGA. Thank you, Dr. Gootnick.
Mr. Bent, please defend yourself.

STATEMENT OF MR. RODNEY G. BENT, DEPUTY CHIEF EXECUTIVE OFFICER, MILLENNIUM CHALLENGE CORPORATION

Mr. BENT. Thank you, Chairman Faleomavaega, Mr. Burton, Mr. Rohrabacher, and members of the subcommittee. Thank you for the opportunity to describe our work in Vanuatu and talk about some of these issues. I am submitting a full statement for the record. I would like to just highlight a few points.

Mr. FALEOMAVAEGA. Have you ever been to Vanuatu, Mr. Bent?

Mr. BENT. No. The closest I have been to is—

Mr. FALEOMAVAEGA. So you have actually never been there.

Mr. BENT. No, I haven't. I thought, however, I might start off with a comment from one of the ministers in Vanuatu who said this program is vital to Vanuatu and a role model of aid effectiveness for other donors. So if I could start off by pleading that our number one client here thinks we are actually doing a good job. Well, we will hope it is transformative. Today's hearing is on the Millennium Challenge Account Corporation overstating its impact in the case of Vanuatu. We are not. We respectfully disagree with the opinion that we are overstating MCC's impact in Vanuatu. MCC is reducing poverty by stimulating economic growth in Vanuatu, and even though GAO's portrayal of the Vanuatu compact's expected impact reflects a different interpretation of MCC's analysis, the bottom line is that the program there will significantly benefit the country's poor. GAO's own analysis using MCC's underlying data supports this conclusion.

As an innovative and progressive model for development assistance, MCC awarded grants, what we call compacts, to 13 countries worldwide. One of those compacts is for over \$65 million with Vanuatu. It was the people of Vanuatu that decided that costly and unreliable transportation is an impediment to economic growth. About 70 percent of the Ni-Vanuatu working population are farmers or in the tourist-related industry. It is no coincidence that Vanuatu's compact, therefore, invests in 11 infrastructure projects. Poor farmers can get more of their vegetables and other crops to market with less damage, and command higher prices. Beaches and vacation sites are more easily accessible, creating demand for labor at hotels, restaurants, artisan shops, and stores. And although this was not part of our calculation, students can get to schools more quickly; patients can get to health care clinics more quickly.

In fact, one of the consultations we held was with the leaders of women's groups, and they pointed out that pregnant women, frankly, leave a month or 2 before they are due to get to the hospital because the transportation system is so bad in Vanuatu. So we didn't count any of those costs in our economic analysis, but they are a true benefit.

While both MCC and GAO agree that Vanuatu's compact will help the poor and positively transform the economy, the audit report questions the degree of expected benefits. We welcome GAO's analysis of MCC, most particularly its focus on the beneficiaries. The long and short of MCC's mission is reducing poverty through

economic growth. The more agencies, think tanks and universities analyze and discuss the benefits of MCC's compacts, the better. MCC is absolutely committed to operating openly and transparently. We are happy to share our data, our methodology.

In the case of Vanuatu, we gave the GAO over 400 documents and 10,000 pages of material, spreadsheets, analyses—you name it. Our goal is clarity. We will strive to avoid any ambiguity in future language and avoid any possible misinterpretations. We appreciate the 2 weeks the GAO spent in Vanuatu validating over a year's worth of our work in the island nation and with purpose and professionalism. We welcome discussing the details and the expected impact of the program.

What are the facts? As Yogi Berra is supposed to have said, it is tough to make predictions, especially about the future. What we know is that at least 65,000 Ni-Vanuatu rural poor of the country's population will benefit from our program. Vanuatu ranks 111th, ranked by income inequality. If you are in the city, you tend to be better off. If you are out in the rural areas, you tend to be poor. In areas where MCC is investing cash, incomes range from \$300 to \$2,500. The transportation projects we are making possible will benefit a wide spectrum. Everyone will benefit, but the poor will benefit disproportionately.

With respect to the number of beneficiaries, GAO believes that 65,000 is too high a count. GAO believes that households living away from roads on smaller islands off the coast and main islands should not be counted as beneficiaries, yet considerable professional judgment and experience tells us those households are still connected with the greater economy of Vanuatu, and MCC-funded roads will make those connections all the more vibrant.

In short, with \$66 million we invest through the compact today, we are generating nearly \$124 million in future benefits, which, in a present value calculation, roughly translates into nearly \$600 for every Ni-Vanuatu. These benefits may seem modest to you and me, but they give a crucial leg up to a typical rural Ni-Vanuatu family of five. Business owners, tourism operators and other participants in the economy who live around the poverty line will also benefit. That is clear. It is their investments, however, that are going to drive sustainable growth over the long run.

The MCC point estimate of the Vanuatu compact's expected impact was purposefully in the middle range of possible estimates so as to not overstate benefits. Our methodology was and is explained in detail in my written statement. MCC projects are subjected to rigorous cost-benefit analysis to determine whether the "bang for the buck" is sufficient. Our model and methodology allows us to move forward with the signing of a compact in the first place only if the impact can be substantiated. The analysis confirms and supports that the program in Vanuatu will transform the lives of the poor in a sustainable way and will ensure that our investment of United States taxpayer dollars will deliver tangible, measurable benefits, as it is beginning to do.

Like every other development agency, MCC acknowledges that the basic income data at the household level is often scarce and unreliable in the poorest countries with whom we partner. MCC made a strong commitment to improving the quality of the data on the

countries and funds baseline surveys in all our compact countries. This helps us measure the impact of MCC investments and track the progress toward compact goals. In several cases, these surveys have been used by the governments and other donors for other purposes beyond compact projects.

MCC stands by the projected impact of the Vanuatu compact, and we are proud of the work we are doing not only in Vanuatu, but also in 26 other countries, especially in compact programs in which we are working. We are primary among foreign assistance programs in many ways, including the degree to which we make public our criteria for estimating program impact. We look forward to measuring the actual benefits of this investment once poor farmers can get their crops to market and a broader swath of the population can participate in the economy.

Thank you again, Mr. Chairman and members of the subcommittee, for your interest in the Millennium Challenge Account, and I welcome your questions.

[The prepared statement of Mr. Bent follows:]

Millennium Challenge Corporation

Statement for the Record by Deputy CEO Rodney Bent

Before the U.S. House of Representatives

Committee on Foreign Affairs

Subcommittee on Asia, the Pacific, and the Global Environment

July 26, 2007 at 2:00 p.m.



REDUCING POVERTY THROUGH GROWTH

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MILLENNIUM CHALLENGE CORPORATION

Introduction

Chairman Faleomavaega, Ranking Member Manzullo, Members of the Subcommittee, thank you for your interest in the Millennium Challenge Corporation's work in Vanuatu.

MCC Model

As a new and innovative approach to development assistance, the Millennium Challenge Corporation is committed to helping countries help themselves reduce poverty through economic growth. *MCC does not partner with all poor countries, only those that are ready to engage with us and that are*

- willing to take on the often difficult work of political, economic, and social policy reforms,
- willing to build their capacity to lead their own sustainable development, and
- willing to deliver results where they matter most—in the lives of the poor.

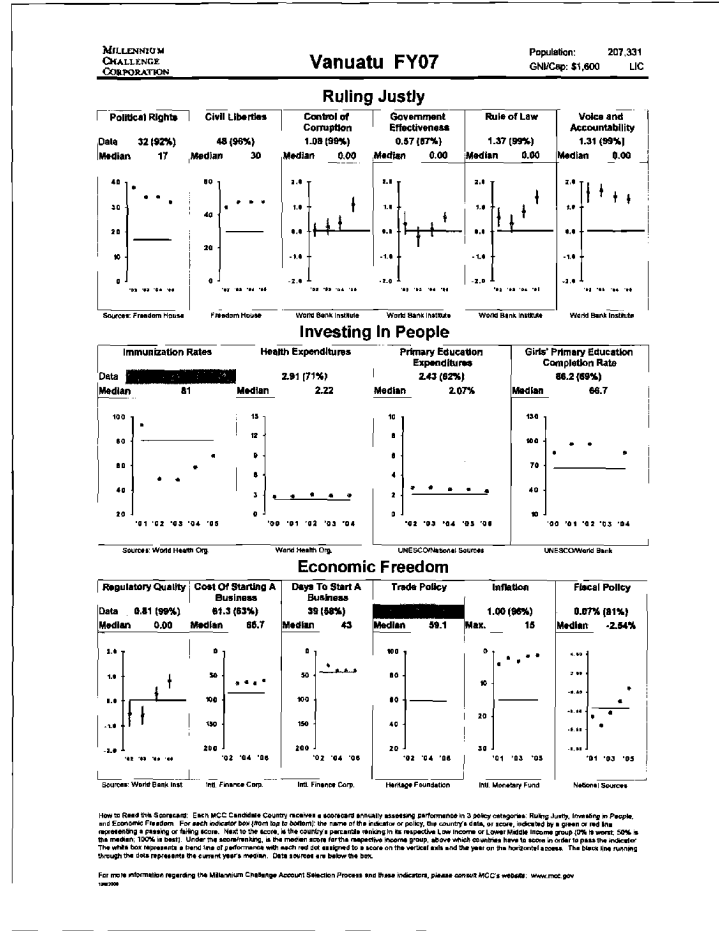
We award grants—not loans—through a streamlined process that applies core principles essential for making the most effective use of development assistance.

- **Selection Process: *First, good policies matter.*** To ensure that our assistance benefits the poor, we select countries that rule justly, invest in the health and education of their people, and promote economic freedom. Objective indicators of policy performance determine which countries qualify for MCC assistance.
- **Compact Development Process: *Second, country ownership is required.*** MCC expects countries to command and lead their development process, from designing a proposal for funding based on consultations with all segments of their civil society, to building the capacity to implement it.
- **Implementation Process: *Third, tangible results are expected.*** MCC and recipient countries together develop progress benchmarks and detailed monitoring and evaluation plans to track the impact of our investments at every stage, and to ensure accountability for results.

To date, the MCC model built on *policy performance, country ownership, and tangible results* has achieved 13 compacts totaling nearly \$3.9 billion with poor countries around the world.

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Exhibit 2: Vanuatu Indicator Scorecard



One of these 13 compacts is with the South Pacific island nation of Vanuatu. Relative to its neighbors, Vanuatu is among the poorest. As summarized by its scorecard, Vanuatu qualified for MCC assistance by passing all but two of the political, social, and economic indicators we use to determine eligibility. Vanuatu seized on its eligibility status, engaged in a broad-based consultative process, and, as a result, developed a proposal for MCC funding to overcome its barriers to poverty reduction and economic growth.

MCC-Vanuatu Compact

The Millennium Challenge Corporation formally notified the U.S. Congress of the start of compact negotiations with Vanuatu on July 22, 2005, and MCC's Board of Directors approved a five-year \$65.69 million compact with Vanuatu on January 3, 2006. Approximately half of Vanuatu's citizens—200,000—live in poverty, and in the provinces where MCC will be working, about 52 percent of the population lives below \$2 a day.¹

Exhibit 1: Vanuatu's Growth Rate Has Been Low

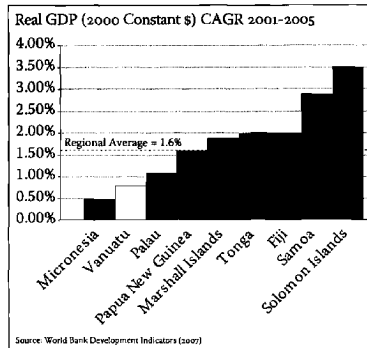
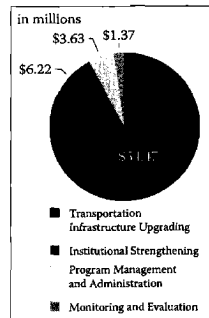


Exhibit 3: MCC-Vanuatu Compact Components



Comprised of 83 islands, Vanuatu identified its costly and unreliable transportation infrastructure as a major impediment to poverty reduction and economic growth. To overcome this constraint, the Vanuatu compact consists of eleven infrastructure projects—including roads, wharves, an airstrip, and warehouses—that will help poor, rural agricultural producers and providers of tourist-related goods and services by reducing transportation costs and improving the reliability of access to transportation services. As a small, open, island economy, agriculture and tourism are central to Vanuatu's growth. These two sectors together employ more than 70 percent of Vanuatu's working population and represent approximately 34 percent of Vanuatu's GDP. The eleven infrastructure projects will allow smallholder farmers to get their produce to market with less damage and in larger quantities to command higher prices. Visitors will be able to reach potential tourist sites more easily, increasing demand for their access and creating business opportunities to provide transport services and tourism activities.

¹ Income distribution is also highly unequal compared to most developing countries. The Gini coefficient, a measure of income distribution in a population, is estimated at 0.56 for Vanuatu or 111th in a list of 124 countries ranked by income equality (0 = total equality and 1 = total inequality), according to the United Nations and independent estimates.

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The compact also includes an institutional strengthening component and policy reform initiatives within Vanuatu's Public Works Department to ensure the sustainable operation and maintenance of the country's entire transport infrastructure network, not only those assets built or rehabilitated with MCC funds.

Response to the Government Accountability Office's Report on the MCC-Vanuatu Compact

Overview

The same accountability and transparency the Millennium Challenge Corporation expects of our partner countries, we expect of ourselves. Therefore, we welcome the United States Government Accountability Office's ("GAO") diligent and thorough oversight of the Vanuatu compact, resulting in an audit report to the Chairman of the *House of Representatives Committee on Foreign Affairs*. Through mutual cooperation and open exchange, we are able to highlight areas of agreement and discuss points of difference. Both MCC and GAO agree that the Vanuatu compact will assist the ni-Vanuatu to overcome their constraints to poverty reduction through economic growth, benefiting the poor and positively transforming the economy. What is at issue is the degree of benefit.

Specific language used by MCC to document the expected impact of the Vanuatu compact led GAO to interpret our results in ways that do not fully capture our analysis. MCC designed its analysis to be conservative and not to overstate the benefits. We maintain that the key statements GAO called into question are factually correct, but we will strive to avoid any ambiguity in official language in future documentation to avoid similar misinterpretations.

We have a fiduciary responsibility to the American taxpayer to make sure that our investments in partner countries deliver results and generate impact. Also, our recipient partner countries demand no less. In the case of Vanuatu, *"The Transport Infrastructure Project is expected to have a transformational impact on Vanuatu's economic development, increasing average income per capita (in real terms) by approximately \$200 or 15 percent of current income per capita by 2010."* Allow me to review the analysis leading to MCC's impact calculations overall and in Vanuatu in particular.

Methodology

To estimate the likely impact of MCC-financed investments, MCC uses *micro-economic growth analysis*. This methodology estimates the expected increases in either value-added or incomes of individuals, firms, or sectors of the economy.

Every project proposed by countries is subjected to a cost-benefit analysis that weighs spending on the program against future expected increases in value-added or incomes. In essence, this "economic rate of return" ("ERR") analysis tells us how far each of our investment dollars will go in delivering growth-enhancing benefits to the

country—that is, their “bang for the buck.” ERRs can be used to compare different types of projects with one another, and we require MCC-funded projects to attain a sufficiently high expected ERR to justify our investments.

ERR analysis begins by laying out all costs associated with the project over the five years of the compact, incorporating any costs borne by others over the compact period and the ensuing 15 years. Then, each benefit stream is quantified over the same 20-year period. For each year, total costs are subtracted from total benefits to create a stream of net benefits. Since costs exceed benefits in the initial years, but benefits exceed costs later in time, the question is whether the positive net benefits received later will justify the up-front costs. When derived from this net benefit stream, the ERR is similar to an interest rate received on the investment, only it is measured in benefits to the ni-Vanuatu.

Based on this methodology, the ERR for all combined projects in the Vanuatu compact was estimated at 24.2 percent. A different but related measure of the expected impact of the Vanuatu compact is the net present value (“NPV”), which calculates the value today of all quantified net benefits occurring over the analytical time frame. The present value of the benefit streams from the Vanuatu compact, evaluated at a 10 percent discount rate, is \$123.5 million which, when reduced by the compact cost of \$65.7 million, indicates a quite substantial NPV of approximately \$60 million.

Given our mandate to reduce poverty, it is equally important to understand who will benefit. Beneficiary analysis is a natural extension of ERR analysis and estimates the distribution of benefits across different types of individuals, firms, or economic sectors. While this analysis is most commonly used to measure the expected impact of projects on the poor, it can have broader applicability to determine the impact on other populations of interest, such as women, the aged, children, and regional or ethnic subpopulations.

Vanuatu’s ERR Analysis and Beneficiary Analysis

ERR Analysis: To prepare the ERR analysis for the Vanuatu compact, MCC subjected each of the 26 projects proposed to us to a cost-benefit analysis. Of these projects, we declined to finance 15 on the grounds that either the projects did not produce sufficient benefits relative to their costs or were technically infeasible. An initial litmus test is to understand from the country how the proposed projects fit into an overall growth strategy. In the case of Vanuatu, the requested roads and wharves help to interconnect households with markets and business opportunities that are currently beyond their grasp. Farmers can now get products to market before spoilage occurs, individuals can commute to jobs in urban areas, and tourists can access regions that were previously remote, allowing for enterprises in those areas to earn more from providing tourist services. We determined the types of activities likely fostered by each specific road or wharf. Not all roads lead through areas likely to attract tourists. Not all wharves provide the same opportunities to export certain types of agricultural products, such as copra, or livestock.

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Thus, the list of expected benefits—and beneficiaries—varies by project. Some examples of specific benefits include:

- increased revenues from tourism,
- reduced wastage of agricultural goods that spoil in transit,
- time savings that can, in part, be used productively when transit times can be reduced,
- reduced vehicle operating costs and benefits to transport providers, and
- increased production of crops and fish in response to improved market opportunities.

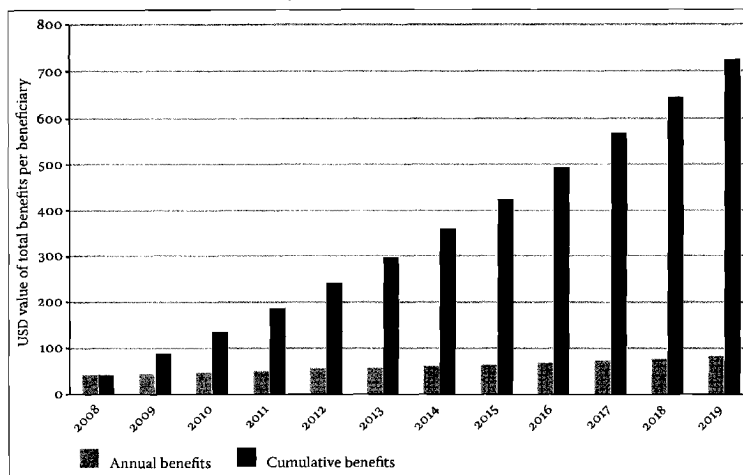
The selection of which types of benefits accrued to which project was determined by site visits, extensive local consultations, and thorough investigation. MCC staff spent more than 100 days in the field during compact preparation, supported by 10 months of international and local consultants and using previous infrastructure studies that reflected at least an additional 30 months of analysis by international and local experts in the field.

MCC then quantified the benefits by comparing “with” and “without project” scenarios over the next 20 years. The expected incremental benefits from the projects were summed and set against the costs to determine the ERR discussed above.

MCC analyzed each of the 11 selected projects in Vanuatu in this way—each with its own carefully considered set of benefits—to produce individual ERRs for each project. It is on the basis of the estimated increased incomes in this exercise that we determined the impact on the overall economic growth rate as well as the distribution of the benefits among different groups.

Beneficiary Analysis: MCC not only quantifies what the benefits of projects will be, but also who will share in those benefits. In the case of Vanuatu, MCC’s extensive due diligence to determine beneficiaries included several steps. First, MCC used detailed population data from the Vanuatu National Statistics Office to overlay proposed infrastructure projects onto detailed maps of communities. This allowed MCC to determine the communities, and their populations, within a reasonable area of influence of the projects. In addition, we used data from the national Household Income and Expenditure Survey to determine the characteristics of that beneficiary population, including poverty rates, working population, and other traits. Finally, MCC’s substantial fieldwork also included site checks of the statistical information, to ensure that the beneficiary analysis matched realities on the ground. On this basis, we could include in the beneficiary population people who lived longer distances from projects, but whose farms were located near the road, as well as populations on some islands more distant from the project, but who would still depend on a project site as their nearest transport option to reach Vanuatu’s few urban areas and services.

Exhibit 4: Total Benefits Per Beneficiary



Sensitivity Analysis: When undertaking the analyses described above, MCC recognizes the presence of uncertainty and risk. The values that we include as assumptions may be uncertain, and there is a risk that forecasted values for items such as construction costs may change. To quote what Yogi Berra may have said, "It is tough to make predictions, especially about the future." In order to address this uncertainty in the Vanuatu ERR analysis, MCC took two approaches.

The first calculates the ERRs for each project for four variations beyond the baseline case. These are:

- the case in which costs are 20 percent above the contingency-inclusive costs used in the baseline case,
- the case in which benefits are 20 percent lower than in the baseline case,
- the best case scenario in which costs are down by 10 percent and benefits up by 10 percent, and
- the worst case scenario in which costs are higher by 20 percent, benefits are lower by 20 percent.

These alternative ERRs can then be compared to see how sensitive the returns are to different possibilities. In the worst case scenario described above, the calculated ERR of 13.4 percent still exceeded the hurdle rate, giving us comfort that the project would still deliver sufficient benefits.

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A second method MCC employed in the Vanuatu analysis was to select a likely probability distribution for each benefit stream. Using these probability distributions, MCC can generate alternative values for the benefit streams that, weighted by their probabilities, can deliver ERRs that better take into account the risks that we believe exist.

Explanation of MCC and GAO Differences

GAO released an audit report stating that MCC overestimated compact impacts in Vanuatu, although, with some exceptions, GAO mainly agrees with MCC's underlying analysis. We believe GAO treated its analysis of MCC's data more like a financial audit in which proof was sought that the poor would benefit in a guaranteed fashion. We believe that this approach is not suitable to evaluating the nature of our work. Rather, we carefully estimate the likely effects of our investments, based on economically sound analysis, professional judgment, field experience, and decades of development evaluations that demonstrate the positive impacts on the poor of improved transport infrastructure. We believe that the poor respond to economic incentives, and we do our best to estimate those responses.

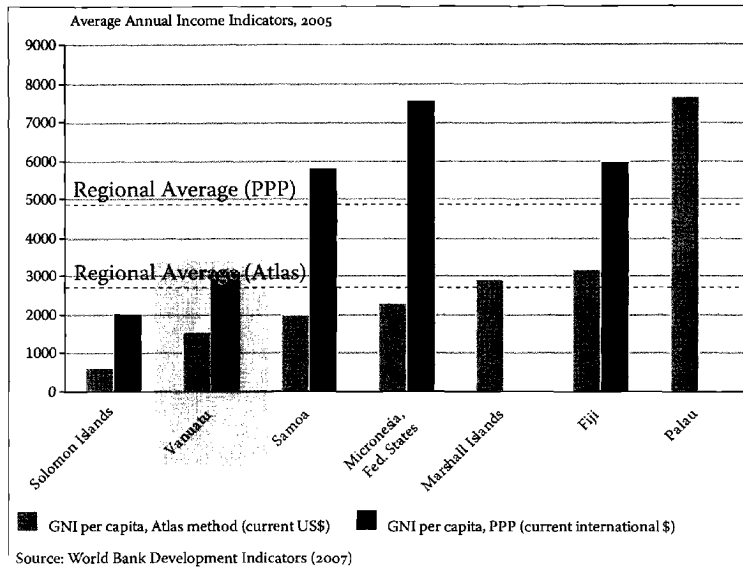
Allow me to summarize the differences in interpretations, which are covered more fully in our comments on GAO's audit report.

First, in terms of compact impact on incomes and growth, GAO incorrectly suggests that MCC erred factually in describing the cumulative benefits of the Vanuatu compact after five years. We stated that per capita income would increase by 15.4 percent by 2010 relative to the 2005 baseline, from \$1,326 to \$1,531 in real terms. GAO's analysis leads a reasonable reader to believe that the cumulative growth over these five years would be only 3.9 percent, which is inconsistent with the underlying data. We accept GAO's assertion that the use of five-year *cumulative* figures can be misunderstood and that *annualized* figures may more clearly portray expected benefits. MCC, however, only characterized them as cumulative figures, as entirely supported by the underlying data.

Moreover, GAO faults MCC's claim that Vanuatu's GDP will increase by an additional three percent a year. The underlying data are consistent with MCC's assessment that Vanuatu's GDP would be perpetually three percent higher with—than without—the MCC investment. The data also indicate that the effect on the per capita GDP growth rate will be moderate but rising, albeit much smaller than three percentage points. GAO interpreted the three percent higher GDP as applicable to the growth rate itself. We understand that a reasonable reader might make this error. As a result, we will certainly reduce any possible ambiguity in official language in future documentation. However, we maintain that the original language was factually correct and in no way intended to mislead.

Second, in terms of compact beneficiaries, while GAO questions the number of beneficiaries who will "receive the majority of benefits," we maintain that the compact will directly impact the lives of more than 65,000 of

Exhibit 5: Vanuatu Income Relative to its Neighbors



the local population in the largely poor and rural project areas in Vanuatu. We expect that near- and non-poor households will benefit from the compact in addition to poor households. Exhibit 5 shows the 2005 average annual income indicators in Vanuatu, relative to the country's neighbors. If MCC is true to its mandate of targeting economic growth as a means to reduce poverty, it is inevitable that households above the poverty line—some not so very far above the poverty line—will also benefit significantly from MCC investments. Vanuatu suffers from exceptionally unequal income distribution, and, for the most part, MCC has chosen to work in relatively poorer areas. While the 65,000 poor, rural beneficiaries cited are not the exclusive beneficiaries of the projects, they will still benefit significantly nonetheless.

Furthermore, GAO argues that the total number of rural beneficiaries included in MCC's analysis should be reduced by one-third. This is based on their untested assumption that households residing in localities with boundaries that are not directly adjacent to or touching the roads, and located on islets off the coast of the main islands, are unlikely to benefit from the compact. We dispute this assumption on the basis of our own substantial fieldwork, which lead us to define beneficiaries as those households residing in localities with dependence

MILLENNIUM CHALLENGE CORPORATION

on, access to, and current usage of the particular road. These conclusions were drawn from field research on communities' economic activities. Compact infrastructure projects represent a fundamental economic lifeline for these communities, in terms of prospects for income generation opportunities and benefits from the agricultural and tourism sectors. Even within this framework, we believe our beneficiary definitions are conservative (particularly for Efate Ring Road, which is the country's major road), given the usage of the islands' road networks by inhabitants of islands in other provinces and tourists.

The MCC-funded rehabilitation of those infrastructure assets will make those communities' connections to the wider economy all the more vibrant and growth-enhancing. We should not discount the large body of development literature that confirms the impact of rural roads on poverty (see Koolwal, Bakht, and Khandker, 2006; Shenggen and Chan-Kang, 2005; ADB, DFID, JBIC, World Bank, 2005²). Naturally, those households closer to the road may benefit more in absolute terms. In counting beneficiaries, however, we do not suggest that benefits are distributed equally across beneficiaries. Variations do exist, and this is unavoidable.

Third, in terms of risks, MCC differs significantly with GAO on the precise nature and severity of risks related to induced benefits, efficiency gains, maintenance, and contingencies.

As for the risks of induced benefits, GAO states, "the projected induced benefits from expanded tourism and agriculture depend on businesses and rural inhabitants responding to opportunities created by improved infrastructure." GAO views the speculative nature of these induced benefits as problematic despite its own admission that "[GAO] fieldwork and meetings in Vanuatu generally affirmed MCC's assumptions about benefits." We aim to catalyze economic growth by providing opportunities to which beneficiaries can respond. Although we acknowledge the difficulty of assessing projected impacts of MCC investments, we feel it is important that we attempt to quantify them given our unique mandate to promote economic growth. MCC's substantial fieldwork included many interviews with tourism operators, farmers, and other business people to gain insight about likely changes in behavior so that induced benefits could be estimated as accurately as possible.

As for risks of efficiency gains, GAO suggests that "efficiency gains – such as time saved because of better roads – ... may not result in measurable changes in per capita income or GDP. Although efficiency gains could improve social welfare, they may not be directly measurable as net additions to the economy." While it is true that time and cost savings may not translate completely into increased income-generating activity, it is highly plausible in a poor country that the majority of these savings would be used to generate income. In recognition that the assumption of full translation of efficiency gains into income may overstate benefits, MCC was careful to include a scenario in which benefits are lower than expected in its sensitivity analysis of the overall compact. It is also important to note that, despite the risks identified by the GAO, other factors not included in the MCC analysis

² Koolwal, Gayatri B.; Bakht, Zaid; Khandker, Shahidur R. (2006) "The poverty impact of rural roads: evidence from Bangladesh," *World Bank Policy Research Working Paper* WPS 3875. Fan, Shenggen; Chan-Kang, Connie (2005) "Road Development, Economic Growth and Poverty Reduction in China," *International Food Policy Research Institute Research Report* 238. ADB, DFID, JBIC, World Bank (2005) *Assessing the Impact of Transport and Energy Infrastructure on Poverty Reduction*.

could potentially raise the returns on MCC investments, including better access to health and education, which would raise overall worker productivity.

As for *maintenance risks*, we believe this risk is overstated and does not reflect a number of recent measures taken by Vanuatu over the past three years to improve its transport infrastructure maintenance capacity, nor the content of the compact itself. For example, the Management Improvement Plan that was developed with the assistance of the Asian Development Bank has led to a significant increase in meaningful capacity for maintenance within the Public Works Department. The European Union continues to provide assistance to expand and strengthen the Public Works Department's maintenance functions, especially in the outer islands. The government increased the Public Works Department's budget for 2007 by \$5.2 million (499 million Vatu), an unprecedented amount. MCC's compact will provide technical assistance and a significant amount of money to alleviate one of the key constraints that prevents timely and adequate level of maintenance by the Public Works Department, namely maintenance equipment. These are sustainable measures, which will continue to yield benefits beyond 2011.

As for *contingency risks*, GAO asserts that insufficient contingencies have been allowed in the build up of construction costs. It cites a survey by Flyvbjerg, Holm and Buhl, which concluded that road projects averaged escalations of 20.4 percent from amounts forecasted at the alternatives analysis stage. Appropriate contingencies should be applied to project cost depending on the stage of the project. The projects that were under consideration in the Vanuatu compact were at an advanced stage in preparation, either at preliminary design or final design stage, not at an alternatives analysis stage. MCC has used certified civil engineers and cost estimators in reviewing and finalizing project specific costs during the due diligence phase. While we were reasonably confident when we signed the compact 16 months ago about our cost estimates, it is always possible that unexpected developments, such as dramatic exchange rate fluctuations, could increase non-US dollar-denominated costs beyond our planned contingencies. Such unforeseen events will lead us to reevaluate the scope of work and, consequently, would impact the number of beneficiaries. These events would need to be handled on a case-by-case basis.

Lessons for the Future

In its report, GAO recommends that MCC take action by:

- revising its public reporting of the Vanuatu compact's projected results,
- assessing whether similar reporting in other compacts accurately reflects underlying analyses, and
- improving economic analyses by more fully accounting for risks to project benefits.

MILLENNIUM CHALLENGE CORPORATION

As we have discussed here today, MCC stands by the projected impact of Vanuatu's compact. Among U.S. foreign assistance programs, we are breaking new ground in the degree to which we make public our criteria for estimating program impact. This applies not only to our compact with Vanuatu but also our other 12 partner countries around the world.

Impact analysis is critical work and requires some informed judgment about a future that may—or may not—unfold as we expect. MCC acknowledges that basic income data at the household level are often scarce and unreliable in the poorest countries with whom we partner. Therefore, MCC has made a strong commitment to improving the quality of data in our partner countries. We have funded baseline surveys in all of our compact countries. This helps us measure the impact of MCC investments, and track interim progress toward compact goals. In several cases, these surveys are being used by the governments and other donors for purposes beyond compact projects. The monitoring and evaluation budget in the Vanuatu compact included substantial funding for expanding and improving the national Household Income and Expenditure Survey, so that the country's poverty rate and income estimates will be much more accurate. In addition, the compact also provides money for a new tourism survey to capture more detailed information about visitor patterns, tourism earnings, and employment rates in the sector. These initiatives will improve both the quality and quantity of key data in Vanuatu.

Looking forward, rather than applying extremely limited staff time to retroactively review compacts already signed or approved, we are focusing our resources and time on the compacts ahead. We will continue to approach impact and economic analyses with rigor and diligence. We will strive to use official language in future documentation that will reduce potential ambiguity that led to misinterpretations in the case of Vanuatu's compact.

Conclusion

The Millennium Challenge Corporation partners with countries determined to lift their people out of poverty and place them on a path to prosperity. Our compacts focus on providing the resources so that countries can help themselves accomplish this goal. Through MCC's compact with Vanuatu, the ni-Vanuatu are leveraging our aid to alleviate poverty that prevents them from fully engaging in the local and regional economy and enjoying a better standard of living. By addressing deficiencies in the transport infrastructure and by strengthening the capacity of the Public Works Department to sustain improvements made, MCC's compact with Vanuatu is a blueprint for reducing poverty and for creating opportunities for sustainable growth for the ni-Vanuatu.

MCC uses a number of measures to calculate how programs reduce poverty through growth. While GAO's report on the Vanuatu compact raises a different interpretation of the results of those measures, we emphasize that MCC-funded programs, including the one with Vanuatu, are generating a measurable, tangible impact in the lives of the poor that is meaningful and transformative. Both GAO and MCC agree on this outcome.

MILLENNIUM CHALLENGE CORPORATION

Thank you, Chairman Faleomavaega, Ranking Member Manzullo, and Members of this Subcommittee, for convening this hearing and allowing us the opportunity to discuss the Millennium Challenge Corporation's impact in Vanuatu. I look forward to answering your questions.

Mr. FALEOMAVAEGA. I don't want to tip the scale in suggesting that I stand in favor Mr. Bent's testimony, but I do want to share with my colleagues that it is an island country with a population of about 207,000 people, 83 islands. So if you want to talk about the infrastructure—it is not like driving a car from here to Richmond, Virginia. To give you that sense of perspective about—these are some of the unique features that a country like Vanuatu out in the Pacific has. I would highly recommend to my colleagues to go and see if our \$65 million investment was worth it.

Mr. BURTON. I would like to go with you. How long does it take to get there?

Mr. FALEOMAVAEGA. You don't want to know.

Mr. BENT. We have had staff go there, and I am told it is 29 hours from door to door.

Mr. FALEOMAVAEGA. Thank you.

Mr. Burton.

Mr. BURTON. I just have a few questions. First of all, I appreciate the testimony of both of you. I understand there is a divergence of opinion there. What I want to find out is when economists—I guess this is for Mr. Bent. When economists and development speak of the effect, what are they talking about? And can you share with us to illustrate that the MCC was having substantial benefits? You may have alluded to some of this already.

Mr. BENT. When countries are competing for our resources, they do extraordinary things. I will give you the example in Vanuatu where they have agreed to set up a road maintenance fund. They increased it by 60 percent largely because they know we wouldn't fund their roads unless they agreed to do the maintenance.

Vanuatu, when it was picked probably about 3 years ago, was in the median, just above the median, on a whole group of indicators about corruption, government effectiveness. These are all indicators done by third parties, not done by us, by the World Bank Institute, you name it. Right now Vanuatu is pretty much in the 90th percentile. They failed regulatory quality in 2004. Now they are in the 99th percentile.

These countries have every incentive to do positive things. In the Dominican Republic, they have set up three commissions dealing with our criteria and are trying to meet our criteria. Because we look at immunization rates, they offered 5 million shots for measles as a way of getting that number up, as a way of appealing to us in terms of what we do. We have got reams of economists I could probably cite who come in, but that is probably their job to say these kinds of things. But, in fact, I think there is a very positive, visible, tangible MCC effect.

Mr. BURTON. Let me ask one other question. You said you had never been down to Vanuatu. Who has?

Mr. BENT. We actually send quite a number of people there. We have a resident country director in Vanuatu. After we sign a compact, we put our eyes and ears on the ground, with a resident country director. Sometimes we have two of them. Frankly, we send a lot of staff to Vanuatu. A couple of our staff, infrastructure engineers and General Counsel's Office, just returned from Vanuatu a couple of days ago.

Mr. BURTON. This is probably just an elementary question. In a place as strung out as this island nation, how do you police all these programs, and how do you get around? I mean, really, I can see how you could get to—what is the capital island? Port Vila. And you go all the way up to the port city up there. I mean, as I look at this, you are looking at 2- or 300 miles over the ocean.

Mr. BENT. We are working only on 8 of the 83 islands. That makes our job easier. In fact, we hired an energetic and rigorous crew, people who generally lived in the country or had experience in the region before we hired them to go out there.

Mr. BURTON. But you do have a very strong policing operation to make sure the funds—because you were talking about corruption earlier, and that is one of our major concerns in foreign affairs and policy and foreign aid.

Mr. BENT. It absolutely is. We hired a procurement agent. We do audits twice a year. We certainly spend a lot of time talking about it to civic organizations, businesses, labor unions, farmers. You name it, we talk to people.

Mr. BURTON. I will let the chairman and my colleague from California continue the questioning, and I am sure they will have questions of you and Mr. Gootnick.

Mr. FALCOMAVAEGA. I thank the gentleman.

I just want to note our Ambassador from Fiji is also our Ambassador to Vanuatu, so I am sure that our Embassy in Fiji is one of our primary resources that assists the MCC.

Regarding the gentleman's question about our Embassy in Fiji, if you start paddling a canoe today, maybe you might get there next week, assuming there is wind and you might use a sail. But they are beautiful islands, and I hope my good friend visits.

The gentleman from California.

Mr. ROHRABACHER. For my education, the colleague from Indiana, he comes from a poor State, landlocked. I know he has been through a briefing. But right now at this moment. Mr. Burton, just for your edification, I know Indiana doesn't touch on an ocean. There might be a river close to it.

Mr. BURTON. We also have some lakes.

Mr. ROHRABACHER. A couple of lakes.

Mr. CHABOT. Most importantly, it is next to Ohio.

Mr. ROHRABACHER. Let me note that I do remember Vanuatu very well, and I have been there a number of times actually. But I do remember how 3 years ago in the middle of the jungle in Espiritu Santo, on one of those roads or paths that I hope that you have now improved, I was left laying underneath a motorcycle. I had been on a motorcycle. I had been in the jungle riding a motorcycle. I ended up pinned under that motorcycle. I would hope that one of the projects has something to do with improving the roads there on that island. I imagine other people rather than just people like myself have been in such circumstances.

And also just for your edification, my friend—I was about to say, this—if you read the Adventures in the South Pacific, Espiritu Santo happens to be the island that Michener was stationed on during the Second World War. And you can see Malahide over there, and I think it is Aruba that is the island—what is the name

of Malahide? What is the name of the island? What is the name of the island in that chain that was—

Mr. FALEOMAVAEGA. If the gentleman will yield, I believe it was the island of Bora Bora. But Bali is one of the places in Indonesia.

Mr. ROHRABACHER. From Espiritu Santo, you can see that island and a silhouette of that island. I would hope also that took into account that there are a number of potential airports, for example, on Espiritu Santo, which my father flew out of during the Second World War. There are a number of very fine runways that are still left from the Second World War, which is 60 years ago. So there is some great potential on these islands, however isolated as they get.

Now to the question in hand in terms of the Millennium Challenge Account. Let me note, Mr. Burton, that if this gentleman had been there and been there a number of times to check that out, that would have been the money necessary for that trip and would have actually been taken from the account that was set aside to help the people of the islands. So there is something to say about not having too many trips to the islands and not having too many people watching the pot, because then the stew that goes into the pot is diminished by not enough money because it costs a lot of money to fly down to those islands—and it is a lot of money per trip.

I do think that the resident country director must have a wonderful job, and I plan sometime to go down there, and I am sure if you go, you will be wearing a straw hat and shorts.

Mr. BENT. He would be happy to show you all around.

Mr. ROHRABACHER. Sandles and et cetera.

I think we have a bookkeeping debate going on here. Mr. Chairman, because of this hearing, I will watch very closely what happens in Vanuatu and does the \$65 million actually impact positively on the lives of these people, because they are in a very poor situation. Although they are happy and wonderful people, they are living in very poor conditions.

I was very impressed with your testimony that because of the Millennium Challenge Account, that they on their own have raised their standards. That in and of itself is a great accomplishment. So it is not just as much pumping in money as it is giving people the incentive to have the right policies which will permit that type of economic growth that benefits the people's lives.

Thank you very much, Mr. Chairman. I appreciate it.

Mr. FALEOMAVAEGA. I thank the gentleman for his comments, and I would like to add also the fact that we have already committed \$3.9 billion to these 13 countries, and we are looking at Vanuatu at \$65 million. I was kind of suggesting to my colleagues, let us not look at Vanuatu as the example of failure. I cannot stress the importance of this hearing because we are planting a seed now. Exactly how we are going to go about in making sure that the measuring of the standards that we are applying, the statutory requirements that we are making in giving Mr. Bent and the others the job to do, that we don't personalize the efforts, to make sure that we fully address the needs of the poor people living in this one particular country. So my suggestion is that they are looking at a project worth \$830 million versus a project that is only \$65 million.

And we are so picky about every penny. I just hope my colleagues will not be critical of Vanuatu's case in suggesting that there is a lot of hanky-panky going on here and corruption and whatever it is.

My good friend, the gentleman from Ohio.

Mr. CHABOT. Thank you very much. I will be brief, Mr. Chairman. Thanks for holding this hearing. I apologize for just getting here recently. I have two other hearings I just came from.

Just one question. The concern that I have always had with the Millennium Challenge Account—and I certainly agree with the goals and the criteria for rule of law and economic freedom and investing in people, all the things that are required in order to qualify for this additional funding. My principal concern is all those—all the foreign aid money that we give, we ought to only give it if the countries are agreeable to doing those particular things, as opposed to having this pot on top of everything else and saying we are really going to require these things to be done in these cases, but not really enforcing it in all the rest of the foreign aid, which is much more than this relatively small pot in comparison with all the aid that we give as the Millennium Challenge Account. So could either one of you gentlemen, if you would, like to comment on that? I would be happy to—

Mr. BENT. Let me say a couple of words. One, I think the principles behind the Millennium Challenge Account, meaning the selection criteria, attention to results, measuring things along the way, making sure that you deliver what you say you deliver, are the principles that probably everybody in the U.S. foreign aid establishment want to see. Ambassador Danilovich had a couple of conversations with the acting USAID Administrator. She is interested in what we do and how we do it. So we are hopeful, in fact, that good practices will be used more universally.

Frankly, we have had a lot of other donors, including some surprising countries, come to us and say, "Well, exactly how are you doing this, and how do you measure this way, where do you get your criteria from, why do you use third parties?" Those are all positive things.

Mr. CHABOT. Did you have a comment.

Dr. GOOTNICK. I would say that there are actually a number of points of agreement between Mr. Bent and myself, and I want to make sure we don't fail to acknowledge them. First is that the underlying premise of MCC is a very sound one and one that may yield significant results.

Secondly, with respect to Vanuatu, we agree that the selection of projects is a rational one. It is consistent with the Asian Development Bank; it is consistent with the national development strategies of the Vanuatu people which were proposed by the Vanuatu people.

Where we disagree and disagree significantly is on the issue of the portrayal and the significance of the following with which a portrayal was made, and also on some of the risks associated. Let me offer you an example, and I need to rebut, respectfully, that this is a bookkeeping issue. If, Mr. Chairman, you earn \$100,000, and I tell you I am going to transform your income, your income is going to be 15 percent higher in 5 years than it is today, and

everything I tell you and every document and everything I have told the Congress tells you that your income is going to be 15 percent higher than it is today, you have every right to believe your income will be \$115,000 in real terms 5 years hence. In fact, it took us wading through the thousands of pages of documents that Mr. Bent alluded to realize and determine that actually the benefits you will receive are 4 percent, and your income will be slightly less than \$104,000 in real terms 5 years hence. So the lack of transparency to us is a credibility issue. It is not a bookkeeping issue.

Then the last thing I would say is with respect to the risks that were considered. For example, when I spoke about reduced benefits being realized in the short term, MCC's calculation of benefits is that the minute they cut the ribbon on these projects, they achieve a high rate of reduced benefits.

Again, the points of agreement, the premise of MCC is sound. The selection of the projects is sound. There is a significant credibility gap in the portrayal.

Mr. CHABOT. I yield to the gentlemen in the committee.

Mr. BURTON. Real briefly. As I understand, according to the GAO, you are not alluding to the possibility that there is fraud or malfeasance or anything. You are just saying what they are telling us is overstated. Let me just follow up.

So what I would like to ask you, if that is the big difference, that they are just overstating things and their success, and it is really not fraud or abuse or any criminal activity or corruption on the part of local officials, then what I don't understand is if it is overstated or isn't, the money is being put to a good use, and is it being used for the purpose of which it is intended?

Dr. GOOTNICK. Well, two points. One, they have overstated the—they have portrayed the results in a misleading way to you, to the Vanuatu people, and to all parties who may be interested in the results of these efforts.

Secondly, with respect to the money being put to good use, in actual fact there has been about \$1.7 million dispersed in Vanuatu to date on the \$65 million project. And the inspector general, as of earlier this year, found that about \$100,000 had actually been vouchered. So a year or more into the project, they are at about 16 percent of the money they had planned to spend. So there are issues with respect to the rate at which the project is proceeding, and there is a statutory 5-year deadline on MCC compacts.

Mr. BENT. Can I address some of those points?

Mr. BURTON. Yes. It is up to you. You have the time.

Mr. BENT. Let me respond to the difference between "annual" and "cumulative." I think I will start off by saying that actually we have a great relationship with the GAO. They wouldn't spend so much time with us if they didn't like us. So, frankly, we welcome all of the oversight that they have done. It helps us sharpen our case so that in some manner I think it is appropriate that the GAO should say, "Wait a minute, you are talking about cumulative impact."

If somebody says to me, "I am going to give you \$1,000," I don't sit down and say, "Gee, I am going to give you \$1,000, but it is really in \$50 increments over a period of time." And that was in the spirit of how we wrote it. I think that one of the questions

where we need to do a better job is clearly explaining to the countries the number of beneficiaries.

I am reminded a little bit of Harry Truman. He said he wanted a one-handed, a one-armed economist, because they kept saying on the one hand and on the other hand. When you are estimating out 20 years, we are building a lot of calculations on a lot of assumptions about a lot of things that we don't know very well.

Take the 65,000 beneficiary figure. That, in fact, is an 8-year-old figure. I am willing to bet that there are probably a lot more people living there than 65,000. But we didn't try to say, well, let's say the growth rate is 2.4 percent, let's add this onto it and pile uncertainty on uncertainty.

On the slow disbursement, one reason it is slow is that we fired the procurement agent because he wasn't doing the job we thought he needed to do. Our goal is to spend the money; it is not to spend it hastily. It is to do a good job. We want to show not only the people of Vanuatu but the American taxpayers that they are getting fair value for their money. So we are going to do this in as rigorous and thoughtful a way as we possibly can.

Mr. CHABOT. Mr. Chairman, I will yield back the balance of my time.

Mr. FALEOMAVAEGA. I thank the gentleman from Ohio for his statement and the questions. I think it seems to me that the problem that we are faced with here is a matter of interpretation of the Federal statute, and what I understand are the standards that the Congress has set forth for which the MCC takes its walking orders in terms of how you can best implement the provisions of the Millennium Challenge Account legislation.

My understanding is that these three performance criteria are the basis of how the MCC goes about in establishing compacts with, now, 13 countries. The criteria ruling justly—I guess you are talking about a transparent government somehow, that you are not dealing with a dictatorship and situations like that.

The next criteria is investment in people; whether or not this economic assistance given to this country goes directly to the benefit economically of the people, whether they are poor or whatever, it is what the country feels is most urgent for the development and the funding that we provide for that country.

And the third criteria is economic freedom. I suspect that what—here again as a matter of interpretation, what does it mean by economic freedom? And Mr. Bent, as you have alluded earlier is that you are doing a cumulative economic overview of what happens to Vanuatu, and you are suggesting the GAO is conducting somewhat of an audit report. In more specific terms, they are not really looking at the overall picture. Am I getting the right frame of mind in terms of you two individuals are differing in expressing this? And do you come up with different results?

And I want to say that under the question I want to pose to Mr. Gootnick, are we doing similar studies of the GAO of the other 12 countries that are currently implementing its compacts with the MCC? Because, obviously, it is just one country. But I would like to do a little more than to see if there is a common thread on how every MCC's performance—is it a case by case? Or is MCC being consistent in applying these standards so that every country that

applied would know what to expect from them, rather than Vanuatu given a different case as opposed to the 12 other countries.

Dr. Gootnick.

Dr. GOOTNICK. Chairman Lantos has asked us to review other compacts. He asked us to look at Vanuatu first, because I believe he had a concern about the results that were portrayed when the congressional notification was put forward.

Mr. FALEOMAVAEGA. And I also note for the record that there was a recent academic study made in Australia by a group challenging the MCC's funding, or how it rated Vanuatu, and made the suggestion that countries like Samoa, Fiji Kiribati and Tuvalu had a greater success of raising the per-capita income or whatever the economic state is as compared to Vanuatu. And I will say, some of the leaders of these island nations complained to me. They seem to have been disqualified for some reason or another, or maybe they haven't properly submitted their paperwork for their applications.

Mr. BENT. No. We look at every country. Nobody really, in fact, applies. What we do is whether they want to or not, we look at them, we rate them, we put everything up on our Web site. I don't specifically remember how some of those countries come off. Some countries like Samoa, in fact, do meet some of the criteria. But Samoa, by World Bank likes or our likes, rather, is a lower middle-income country. Our legislation has a cap of 25 percent on what we can do in lower middle-income countries, so we try to focus on the poorer countries.

Mr. FALEOMAVAEGA. So Samoa is not as poor as Vanuatu? Is that why they are—

Mr. BENT. Well, not so much that they are disqualified, but they are a bit better off than Vanuatu. I have a chart in my longer testimony that shows the relative incomes of several countries.

Mr. FALEOMAVAEGA. I would like you to submit that for the record, too, Mr. Bent.

Mr. BENT. Yes, sir.

Mr. FALEOMAVAEGA. I would like to know from Day One how many, and just to see it in terms of poverty levels of each country. I am sure the United Nations has similar data, but I think it would be very helpful. I want to build a record on this because, as I say, this hearing is very important on how we are going to be looking at how the whole Millennium Account legislation is being implemented. And I think it is quite obvious from the perspective of the members here, we just don't want to waste Uncle Sam's money, put it in those terms; and secondly, we don't want a bureaucratic confrontation like you do here, and you end up with the bureaucrats fighting amongst themselves and the intent of the funding that is to be provided to these countries comes to an end. And I think that defeats the purpose of what we are trying to achieve here.

Dr. Gootnick.

Dr. GOOTNICK. I agree very strongly with what you said. I do think, though, that the issue here is one of transparency and ultimately of credibility. Five years hence, the MCC will be held to a standard of the results that it is portraying and projecting today. And if at that time in Vanuatu, even if the project succeeded and

all went well, they would not have achieved the results that they are portraying today, their credibility would be significantly challenged. I would encourage anyone here to go to their Web site today and look at Vanuatu. Look under the banner of Vanuatu and see what you interpret to be the projected results of this compact, and ask yourself if that is transparent, credible, good governance.

Mr. FALEOMAVAEGA. I think the problem here, Dr. Gootnick has said, who makes the judgment to say the government is transparent enough to be a recipient of this award? I just noticed that there were problems, a vote of no confidence of the present Prime Minister of Vanuatu, I believe. And so does this automatically put a whole dark cloud and suggesting that the compact does not move forward at the expense of the people in poverty? Thousands of them could be beneficiaries to what the whole compact was intended to achieve here.

Dr. GOOTNICK. Right. The transparency I referred to here is the transparency of our Government, of the Millennium Challenge Corporation. You are very correct that the issue of transparency in the Government of Vanuatu is key, and it is one that, again, there is a point of agreement between ourselves and the Millennium Challenge Corporation that they look at the 16 indicators, they get objective data—it is imperfect data but it is the best data that is out there—and they do a rigorous analysis by some predetermined criteria as to who is eligible for their assistance.

Mr. FALEOMAVAEGA. My question to Mr. Bent, am I to understand that the standards that you have implemented with the Vanuatu Compact is exactly the same standards you would implement in the 12 other countries?

Mr. BENT. Right.

Mr. FALEOMAVAEGA. That have been recipients of the \$3.9 billion?

Mr. BENT. All the countries go through the same rigorous selection process. All the projects go through the same economic and, frankly, environmental and social and gender analyses to make sure that we are really doing the right thing.

I would emphasize one point of agreement with Dr. Gootnick: We think that our beneficiaries need to know. So therefore, we want to make sure what we are doing with them is saying, This is what we have agreed upon doing. Do you agree? Yes. And then we go forward.

Mr. FALEOMAVAEGA. I think the other problem—I think the other concern here that was raised also by other members of this committee is why Vanuatu was selected among all the countries in the Pacific? Was Vanuatu a member of the coalition of the willing during the war? Was there any real special political treatment given to Vanuatu? Why Vanuatu's application was accepted and several others that were submitted were rejected? What put Vanuatu as the shining example of how the MCC could best apply its—

Mr. BENT. Vanuatu was in that first group, the 16 countries that were picked. They passed 13 out of the 16 indicators. They were a low-income country. In fact, since then, they have done even better. So I think for all 4 years they have been eligible, they have met the criteria. So that was it, long and short.

I had heard that there had been a notion that somehow this was a political reward. The closest thing I can find, frankly, is the then-Foreign Minister saying he didn't approve of the invasion. So if we are rewarding our friends through the MCC, it is not a very—

Mr. FALEOMAVAEGA. Well, I am glad you stated that clearly for the record. Because I do not want to have this sense that some members of the committee believe that the reason why Vanuatu was awarded this is because the administration wanted to award those countries who were members of the coalition of the willing.

Mr. BENT. They are in on their merits. Nothing else matters.

Mr. FALEOMAVAEGA. Dr. Gootnick, and both to you, Mr. Bent, as well, do you see any problems with the current legislation or the law that implements the provisions of the law as it is within the Millennium Compacts? I mean what I want to know is that obviously there is a problem of interpretation that has come up from the GAO and also the problem of how the MCC has gone about implementing these provisions.

Mr. BENT. Sure.

Mr. FALEOMAVAEGA. Do you suggest any provisions of the current law that we ought to address and make it more transparent on our part, so that there could be no questions, so that GAO doesn't have to, you know, wonder too, was this correct the way the MCC was implementing this provision or that provision? I would be very appreciative of you to offer any recommendations that you would like to make. Because you know, Congress doesn't necessarily do the best thing or the right thing all the time. And if there are weaknesses in the current law and how—in other words, giving you more heartaches and problems, trying to figure, well, what did they really mean? And then maybe we won't have as many GAO audits, or whatever it is, implementing this provision of this law.

Mr. BENT. There are a couple of provisions that I think would welcome changes in the current authorizing statute. One is that right now we can't do concurrent compacts. In other words, we couldn't go back to Vanuatu and have a second compact. What we have learned is that for that MCC incentive effect, and especially when we create an accountable entity in each of these countries, there are real economies of scale that we could take advantage of.

So point one would be getting authorization to have concurrent compacts.

Point two, this is probably not going to be the case in Vanuatu, but in some of our other countries construction projects are highly uncertain. Costs do go up. David is quite correct about that. And sometimes it takes longer to do something. So having relief from the 5-year limitation that we have got now, perhaps doing a longer term compact.

The third thing, and this applies directly to possibly eligible Pacific Island countries, is there a way that we could consider other mechanisms? And that might be appropriate. My own sense, frankly, is that the issue between GAO and MCC over the beneficiaries is not a legal or an authorizing issue. It is an analytical issue in which respected professionals can frankly disagree. I never have seen headlines where you get the notion of "MCC understates impact crime to be prevented" sort of headline. So I think that in this particular case we will continue to have conversation. We want to

do an even better job of being transparent, but I don't think that is a question of the authorizing legislation.

Mr. FALEOMAVAEGA. One thing that I am very much aware of among most of these Pacific Island nations is their capacity. What I mean by this is having a sufficient number of professionals locally among the local people: Doctors, lawyers, auditors, professional people. And I know that Vanuatu has a very close working relationship with Australia.

And let me ask you a question. Were most of the people involved in transforming this application process, was done in cooperation from expatriates who are CPAs, people who were over there, were they, let's say, predominantly Vanuatus themselves?

Mr. BENT. It is the Ni-Vanuatu who do it; it is church groups, women's groups, farmers.

Mr. FALEOMAVAEGA. No. No. No. What I mean is that the actual professional people that understand economics and how this whole paperwork is being filled. What I am saying, how many expatriates were involved in the process of developing this compact? And I am talking about good professional people. I am not—I am not knocking this suggestion that it was a bad thing.

But my point is that a lot of times when it comes to application times, leaders of these governments rely a lot on expatriates who are contracted to do the work for them, simply because there aren't enough experts among their own people to do the work.

Mr. BENT. Good question. If I can, let me answer it for the record.

Mr. FALEOMAVAEGA. Could you please? I would like for you to submit that for the record.

[The information referred to follows:]

WRITTEN RESPONSE RECEIVED FROM MR. RODNEY G. BENT TO QUESTION ASKED DURING THE HEARING BY THE HONORABLE ENI F.H. FALEOMAVAEGA

The Government of Vanuatu drove the MCC compact development process from start to finish and are responsible for the rational of projects and composition of the proposal.

The Government of Vanuatu's Department of Economic and Sectoral Planning (DESP) prepared a paper identifying constraints to economic growth and poverty reduction that was then vetted through the "Central Agencies Group," consisting of Directors-General from relevant ni-Vanuatu ministries. Throughout the process, consultations were held with the annual Priorities and Action Agenda (PAA) summit, National Business Forum, bi-annual Comprehensive Reform Program (CRP) summits, and provincial-level Rural Economic Development Initiatives (REDI) plans.

The CRP summits are bi-annual meetings which bring together representatives from the Government of Vanuatu, NGOs, the Vanuatu National Council of Chiefs, National Council of Women, Council of Churches, private sector representatives and general civil society. The National Business Forum provided a forum for dialogue between the government and the private sector representatives on issues that affect private sector development.

During the due diligence process, MCC hired Parsons Brinckerhoff to assist in developing feasibility studies on the infrastructure projects in conjunction with the ni-Vanuatu. It was this expertise that the ni-Vanuatu used where outside assistance was required to develop comprehensive studies. While Parsons Brinckerhoff updated the economic rate of return (ERR) spreadsheets, the initial ERRs were submitted by the Government of Vanuatu with their original proposal. All of the proposed projects and consultations were run by the ni-Vanuatu. Additionally, MCA-Vanuatu had approximately 1 week of technical assistance provided by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP).

Vanuatu is an example of an MCC country pulling together its resources, both in the government and in the community, to put forth a proposal that encompasses its

own vision of what is required to reduce poverty. Expatriate advice and support was solicited by the ni-Vanuatu only when and as needed to support a process driven by the ni-Vanuatu themselves.

Mr. FALEOMAVAEGA. Now, as you were discussing earlier about transparency, the problems that we are faced with the current legislation, would you think there would have to be different milestones or deadlines when you are looking at a country who is applying for an \$800 million compact versus a \$65 million compact? I mean, nitpicking every little penny of the \$65 million, but \$800 million is a little more involved, I am quite sure. And you can't tell me that the paperwork is exactly the same.

Mr. BENT. I am going to let David handle the nitpicking part.

Mr. FALEOMAVAEGA. Dr. Gootnick.

Dr. GOOTNICK. Well, as I understand the provisions of a compact as it operates, by and large, if you look at the compacts to date, they have been—they have hued very closely to each other. So the compact with Benin or the compact with Mali looks very similar in its form to the compact with Vanuatu. I am sure there are features that are unique. But, by and large, structures that are put in place to provide oversight at the country level, the requirements of disbursement of funds, the requirement for auditing of funds are quite similar.

Mr. FALEOMAVAEGA. I think the United Nations bases a standard, what is considered a least development country, LDCs they call them. How many LDCs do we have currently right now in the world? Any guess? Can you submit that for the record Mr. Bent?

Mr. BENT. Sure. The U.N. Human Development Index looks at 125 countries and they break them down in categories.

Mr. FALEOMAVAEGA. And Vanuatu rates 114th or something like that?

Mr. BENT. Well, that was a different statistic. Let me answer that for the record. I will be able to do that.

Mr. FALEOMAVAEGA. Please. I would be very curious exactly—would you think that among those countries that are categorized or labeled, I think by the United Nations, especially the World Bank and other regional institutions, that least developed countries are the ones that are considered poverty, the worst off, if you will?

Mr. BENT. Yes, sir.

Mr. FALEOMAVAEGA. And should these countries have a higher priority for the MCC look to at for real help as far as meeting poverty problems that most of these countries are faced with?

Mr. BENT. We only work in low-income and lower middle-income countries. What we ask, however, is that the countries show a demonstrated willingness to govern themselves wisely, to invest in their people, and to promote economic freedom. And not every country is going to do that. There are a couple that aren't much in favor of those things.

Mr. FALEOMAVAEGA. Here's a curve ball I want to throw at both of you. We have under a statute in the law that if a country—if there is a military coup that occurs in a country, we automatically put sanctions on that country.

Okay, now I am faced with a predicament here. Six years ago a general by the name of Musharraf committed a military coup in

Pakistan. Six years later he still hasn't called elections. There is absolutely no democracy in Pakistan to this day, 6 years now.

Fiji committed a military coup last year and we immediately started putting sanctions on Fiji, and I think also due to our total ignorance in understanding the cultural social nuances that have developed in that country in terms of its very unique problems.

Thailand also had a military coup that took place, and we also put sanctions on that country. In fact, Thailand had about 14 coups even before that.

And as far as I am concerned, not only are we applying a double standard here, to me it is the height of hypocrisy. We are making demands that countries become democratic, and yet we allow Musharraf to continue his dictatorship role simply because we are supposed to be working with him to fight terrorism.

But other countries, because of their unique situations, would put sanctions on them because they are not fighting terrorism as much as Pakistan. So where is the fairness in our current rule of law? Does a country like Fiji qualify for the MCC Compact even though it is under a current military rule? Does Pakistan qualify for the MCC compact?

Mr. BENT. No. Your question is a good one, but it is best directed at the Secretary of State.

Mr. FALEOMAVAEGA. Well, I am curious because we give a lot of assistance to Pakistan. And I am curious if Pakistan has made application to take into the pot, the \$6 million pot we have here that we give to countries. And you can't tell me there are not enough poor people in Pakistan that need this assistance. So I just wanted to present that to you, some of the problems that we are faced with legislatively and the unfairness of the process.

The chairman of the committee had requested perhaps that GAO studies also be conducted among the other 12 countries. Dr. Gootnick, did I hear that? Or I am going to certainly confer with him closely about doing this as well. Is this the only GAO study that has been made among the 13 countries that currently have compacts with the MCC?

Dr. GOOTNICK. This is the only study of this nature that looks specifically at the underlying analysis that led to the projected economic impact in the way this has. We have looked at other compacts primarily to understand and examine the structures that were being established in the country to begin to execute projects.

In the first year of MCC's operations, we looked at some of their management structures internally as they were building the staff, the budget, and the internal controls to run the operation in Washington. And also early on, we did look at the eligibility criteria that has been discussed here in terms of the analysis that is undertaken with the raw data of the indicators to produce eligible countries.

But, yes, it is my understanding that Chairman Lantos, through his original request, had asked us to work on additional countries. What we intend to do is work closely with his staff to determine how they would want us to proceed at this point.

Mr. FALEOMAVAEGA. I had a recent meeting with about four Prime Ministers and heads of state for the Pacific Island nations that came to Washington. And this was one of the issues that was discussed about their qualification to apply for an MCC compact.

And the concerns that were raised to me is the fact that they say, well, most of these countries are LDCs, and they were still not given the green light to say you can go ahead and submit your application.

Samoa is one of those examples. I think it is still rated as an LDC. And you say they don't qualify because the per-capita income is too high.

Mr. BENT. I am saying they are a lower middle-income country. And in our legislation we have a cap of doing only 25 percent on lower middle-income countries. So we can work in lower middle-income countries. El Salvador is an example. But the amount of resources that we can provide to a country like Samoa would be legislatively constrained.

Mr. FALEOMAVAEGA. Why would that be? Why would that be?

Mr. BENT. I think the intent of the restriction was to make sure that we stayed focused on the poorest of the poor.

Mr. FALEOMAVAEGA. The poorest of the poor. Let me ask, are there any provisions of the law, Mr. Bent, that are causing any problems in the administration or implementation of the statute where, as I have said earlier, the differences here are coming where the GAO has an entirely different perspective from how you are currently going back about and implementing the provisions of the current law?

Mr. BENT. Not so much with respect to the issues that we talked about today. There are a couple minor provisions involving the Federal Register, or the terms of our board members, that we would like to have a discussion about.

Mr. FALEOMAVAEGA. Dr. Gootnick?

Dr. GOOTNICK. I agree with Rodney that the issues that are being put forward today don't have specific legislative implications for the authorizing—for MCC's authorizing legislation. But again, we are of the opinion that full, honest, transparent, disclosure to Congress and the Vanuatu people of what results are being portrayed and projected is much more than nitpicking and, indeed, of great interest to the Congress.

Mr. FALEOMAVAEGA. Mr. Bent, the MCC in its operations, are you under the State Department in any way or form? Or you serve as an independent corporation?

Mr. BENT. We are an independent corporation, but the Secretary of State is the chairman of our board. The USAID Administrator is a member of the board; Secretary of the Treasury is a member of the board. The U.S. Trade Representative is on the board as well. And we will have four private members. So that, plus the CEO, compose the nine members.

Mr. FALEOMAVAEGA. Does the Secretary of State have all that time to commit herself in working as chairman of the MCC?

Mr. BENT. I can honestly say that she has been very involved in asking us some pretty tough and pointed questions about what we are doing and how we are doing it. So she is very much involved.

Mr. FALEOMAVAEGA. So there is no question that as far as the total overall operation and implementation of the MCC account under State Department is part of our foreign policy?

Mr. BENT. We are subject to the foreign assistance restrictions, if you will. But in terms of day-to-day direction, no, we are an independent agency.

Mr. FALEOMAVAEGA. How does this differ from our current program in USAID?

Mr. BENT. Well, USAID is, in some sense through the new process and everything else, integrated with what the State Department is doing. We share information with the Secretary of State, State Department, and USAID. We want to know if they have had certain success in certain countries. We certainly take advantage of everything USAID with its 50, 60 years' worth of experience has done. We will take advantage of what the MDBs or NGOs have learned. And I will say just that GAO has been helpful to us in terms of saying, Well, hey, this could be misinterpreted, or did you really mean that? So we don't want to be defensive about criticism. We welcome it.

Mr. FALEOMAVAEGA. I am quite sure that this is the holding tent, Chairman Lantos' initiative also to have the GAO look into the process. Not that we are trying to point fingers at anybody to show how long that you are doing the program. I think the whole point here is if there are questions, if there is an even standard being applied to all those applicants, and do you consider 13 countries a pretty good tempo that we are operating under or should it have been more? Or is it because it is a slow process, all the paperwork that has to be going on, is there too much paper shuffling going on?

Mr. BENT. I think we have been rigorous internally in saying are we really asking countries for what will reduce the risk. So, for example, we have reduced our legal documentation by two-thirds. We are forever looking at our processes and saying, "Is this really helpful? Does the country understand what we are about or not?" There is always room for improvement.

I have been at MCC about 18 months. I think there has been a change in what we have been doing. That said, I think the problems are in front of us. They are real. Issues of implementation are horrendous. Nobody in this business should have the least bit of hubris about what we can achieve and how we achieve it. But as I say, that is why I welcome the GAO or think-tanks or other people saying, well, heck, is this as clear as you can make it? If it is not, then we are going to do our darndest to make it clear?

Mr. FALEOMAVAEGA. Do you think you would support a proposed amendment on the part of Chairman Lantos and myself that we say that we give LDCs, least developed countries, the highest priority to be considered by the MCC, so that divides automatically, puts a division that says okay, these are—because, obviously, this is where most of the poor people—am I wrong on this?

Mr. BENT. No, sir. What I would ask, however, is that if you would help us with our appropriations because, frankly, our biggest constraint is going to be funding, not the authorizing legislation. The President's request for 2008 was \$3 billion. The House has given us a mark of \$1.8 billion, which will pretty much allow us to do our job and not a lot more this year. The Senate has cut us to \$1.2 billion, and at that level we won't be able to do a number of compacts that we frankly—

Mr. FALEOMAVAEGA. You realize that we have already expended about \$650 billion in that terrible war we got ourselves into in Iraq and we are spending \$2 billion a month—a month—in that terrible war. So I think maybe perhaps the President needs to rethink his priorities in terms of exactly how we could best spend the American taxpayers' money in that regard.

And I don't mean to question what you said about if we are going to make changes, you need to give us more money to operate. And understandably, every agency in the Federal Government asks for more money. Our challenge is to make sure that the American taxpayers' money is properly spent, and I know that is your commitment as well.

Mr. BENT. Yes, it is.

Mr. FALEOMAVAEGA. My good friend, the gentlelady from California, for some questions.

Ms. WATSON. Probably you have gone over this territory while I was out attending another meeting.

Mr. FALEOMAVAEGA. It never hurts to repeat the question though.

Ms. WATSON. I need to ask this. I have been in Vanuatu, and I was there while we were estimating whether NCA should become part of their governmental programs. And I want to know what obstacles that you have found to this point. Now, if it has already been asked, please repeat it for me. But what stands in the way for economic growth in Vanuatu? And which of them are most likely to and least likely to be addressed by our project, MCA?

Mr. BENT. Thank you, Ms. Watson. And let me also thank you for your very kind comments on gender issues. You have been a great leader on this.

Ms. WATSON. I am thrilled about what they are doing.

Mr. BENT. In the case of Vanuatu, the preeminent problem with respect to economic growth that the Ni-Vanuatu identified was transportation: Roads, wharfs, air strips, and warehouses. That is why this compact is entirely dedicated to dealing with those kinds of issues. There are clearly other problems. In every one of the countries we operate, capacity on the part of the society and local government is a constraint. I don't want to suggest that an issue as complex as development is solvable just by putting in roads. You have to do a number of things. You have to have an effective government. You have to have an open economy. You need to do any number of things. But we are certainly part of the answer.

Ms. WATSON. I am very, very familiar with the problems. I lived them every day when I was in the area.

Mr. BENT. Right.

Ms. WATSON. We just had a hearing for about 5 hours talking about the building of our Embassy in the Green Zone in Iraq and the shoddy work that had been done and going out, getting people who, number one, couldn't understand the language that they were given orders in, had different customs and traditions, and they brought a lot of people in who wore turbans and they couldn't take their turbans off to put the hard hats on.

And so what I am saying, well, who did the recruitment? So we are very aware of capacity. Are you familiar with the economic

growth in Vanuatu in, say, in the last year to 5 years? What would that be?

Mr. BENT. It has been low. I am afraid I don't know offhand what it has been in the last couple of years, but it was behind several other countries in the region.

Ms. WATSON. Yeah. What would their growth have to be to bring them up to another level of economic security? If I can use that description.

Mr. BENT. Certainly higher than—I think 3 percent. Population growth is something like 2.4 percent, so you have to get a growth rate in excess of the population to really lift up the real income of the Ni-Vanuatu.

Ms. WATSON. Can that be reached with our assistance, say, within this decade?

Mr. BENT. I think that our assistance is clearly going to make a difference. Even though it is pretty generous on a per-capita basis, it is not by itself going to produce, you know, the 7, 8, 9 percent growth rates that I think are probably required to really reduce that kind of poverty.

Ms. WATSON. But in a realistic way, what could be done throughout this decade?

Mr. BENT. I think it is what we are doing. It is the building of the roads, it is connecting Vanuatu with the economy within the 83 islands and then, obviously, bringing in tourists, bringing in outside investment, doing the things that the Ni-Vanuatu recognize they need to do as well.

Ms. WATSON. Well, we had this discussion dealing with the Marshalls yesterday. Is it realistic to think we can increase the economy with tourism? Because I find in those islands, I was there in the Federated States of Micronesia, and there are no sandy beaches, mangrove, no golf courses. Maybe we can put some in. What would attract the tourists? And no cruise ships that go down. Planes take off once or twice a week. So how would we do that within, say, the decade realistically?

Mr. BENT. Of course. I think that tourism clearly is one of the answers. The growth rates that I saw for tourism were on the order of 15 percent. Tourists are used to a certain degree of infrastructure: Hotels, restaurants, wharfs.

Ms. WATSON. You don't have them.

Mr. BENT. No. And that is exactly what we hope this compact will help address.

Ms. WATSON. We are going to need far more than what is appropriate if we are going to look realistically at bringing about some success within this decade, and probably will be into the next decade. Knowing that area and what I found, I will repeat what I said yesterday, is that there are customs and traditions that have a tremendous impact. And we can't visualize, you know, how they do; but if it is not approved by the highest person, it doesn't get done.

You have to build an entrepreneurial spirit, too. And you have very few, shall I say, private investors that will come in and invest. And you have to have that, too.

So there are a whole lot of factors that I am hoping MCA will take into consideration. We will start at level one and hope to be able to build up within this decade to take us to level two.

Mr. BENT. Thank you.

Ms. WATSON. Thank you, Mr. Chairman.

Mr. FALÉOMAVAEGA. I thank the gentlelady for her comments. And one of the concerns and the problems that I have seen over the years in these island nations, not just in the Pacific, because I am sure it is true even in the Caribbean and other regions of the world, is that we build unrealistic expectations on how the economies of these small entities are going to compete with the modern world.

You raised the issue of tourism. Well, all other countries are competing for the same market in tourism. So I think sometimes we are very unrealistic.

Now, subsistence economy, you can live with that because you don't need to go to another island to catch my fish, my coconuts, and I am a happy man. But to expect that I have to have a wardrobe and five pairs of shoes, the idea that I can travel freely to another country, another destination in these island countries, just the essence of having sufficient water.

As you know, my own personal experience in living in these atolls, water is more important than anything else, and it is not as simple as we—the problem is that we have Western standards. And we say, okay, here is the money; get yourself a good way to live and come up to where the rest of the world is. Not as simple as we think it is.

And then we raise these expectations with these island nations' leaders, and to suggest that the gold is out there and we just have to reach for it, and in a very unrealistic way.

And as you know, Dr. Gootnick, we have the same issues that we raised with a country like the Republic of the Marshall Islands. We did tremendous harm to the environment, to the lives and the properties belonging to the people in the Marshall Islands where we conducted 67 nuclear bomb detonations. It literally blew up an entire island where we conducted the first hydrogen bomb detonation ever in the history of mankind. That is the modern world's commitment to win the Cold War, I suppose. And these island people had no idea, no concept of what was coming, what followed. So now we are trying to rebuild their structures.

And to suggest, as you have, in my humble opinion, the fact that Vanuatu leaders made the right decision; you have to have roads, you have to have wharfs, you have to have these basic infrastructures if there is going to be any sense of economic development just to do these basic things. So I am concerned about this.

And the fact that we can make a projection, \$65 million. They are probably going to need \$800 million if we really want to do a first-class job in helping them, 200,000 people. So this is where it doesn't really—we can paint a real shiny picture and suggesting that this is what we are going to achieve. But realistically, I have some very serious questions where we say to these small entities of these countries that don't have very big economies that it can be done.

Naru is an excellent example where the phosphate is now completely harvested and taken and the island is full of holes. They can't even go back and live there, their own island. The phosphate is gone. Eight thousand people. They squandered up so much of

their wealth, and now it is almost like a small island desert, if you will, because it is uninhabitable. I didn't mean to give you all my grievings here.

Mr. BENT. Happy to receive it.

Mr. FALEOMAVAEGA. But I sincerely hope that this hearing will set the tone, hopefully, to my good friend and colleague from California that I would welcome to submit for the record any recommendations on part of the MCC as well as GAO how we can better develop legislation or necessary amendments to the current law so that we don't have a number of different standards, so to speak; so the GAO will be speaking from the same sheet of music, as you would, MCC. And then we all live together as a happy family. I think it was somebody who said, "Why can't we just get along?"

And with that, gentlemen, I really appreciate your coming and your most eloquent and very, very insightful statements this afternoon. I look forward to working with both of you again in the future.

Mr. BENT. Thank you. Thank you, Mr. Chairman.

Mr. FALEOMAVAEGA. The hearing is adjourned.

[Whereupon, at 3:54 p.m., the subcommittee was adjourned.]

