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United States Government Accountability Office  
Washington, DC 20548

February 21, 2006

The Honorable Richard G. Lugar  
Chairman, Committee on Foreign Relations  
United States Senate

Subject: *Analysis of Future Millennium Challenge Corporation Obligations*

Dear Chairman Lugar:

The Millennium Challenge Corporation (MCC)—intended to provide aid to developing countries that have demonstrated a commitment to ruling justly, encouraging economic freedom, and investing in people—has received appropriations for fiscal years (FY) 2004-06 totaling more than \$4.2 billion. About \$3.8 billion of this amount has been set aside for compact assistance.<sup>1</sup> As of January 2006, MCC had signed or approved eight compacts<sup>2</sup> obligating about \$1.5 billion,<sup>3</sup> leaving an unobligated balance of about \$2.3 billion. To assist in this year's budget deliberations, this letter provides a range of estimates under two scenarios of how quickly MCC could obligate this balance and three possible levels of FY 2007 appropriations at the current pace of compact award. The President has requested an additional \$3 billion for MCC for FY 2007.

To address this objective, we analyzed MCC's FY 2005 and 2006 budget presentations and other corporation records. We selected two illustrative scenarios for future MCC obligations: (1) a "higher cost" scenario in which the average size of future compacts is consistent with MCC projections and (2) a "lower cost" scenario in which future compacts are consistent with the average compact size to date. For both of these scenarios, we assumed that MCC would sign an average of two compacts per quarter—the actual rate observed since April 2005. We discussed our estimates with MCC officials and have incorporated their comments as appropriate. We conducted our work in December 2005 through February 2006 in accordance with generally accepted government auditing standards.

## Summary

Under the higher-cost scenario, MCC would obligate the balance of its FY 2004-06 appropriations in the second quarter of FY 2007. Assuming that subsequent compact size remains consistent with MCC projections, an FY 2007 appropriation of \$1, \$2 or \$3 billion will support the funding of compacts through, respectively, the third quarter of FY 2007, the fourth quarter of FY 2007, or the second quarter of FY 2008. The cumulative number of compacts under this scenario ranges from 18 to 23.

<sup>1</sup>About \$400 million has been set aside for MCC's threshold country program, administrative expenses, due diligence, monitoring and evaluation, and other costs.

<sup>2</sup>The Millennium Challenge Act of 2003 (Public Law 108-199, Division D, Section 605) authorizes MCC to provide assistance to countries that enter into public compacts with the United States. MCC has negotiated compacts with countries that contain agreed assistance objectives, responsibilities, implementation schedules, expected results, and evaluation strategies.

<sup>3</sup>Through January 2006, MCC had expended about \$12 million of the \$1.5 billion obligated for compact assistance.

Under the lower-cost scenario, MCC would obligate the balance of its FY 2004-06 appropriations during the fourth quarter of FY 2007 (about 6 months later than under the first scenario). Assuming that subsequent compact size remains consistent with the average to date, an appropriation of \$1, \$2 or \$3 billion will support the funding of compacts through, respectively, the third quarter of FY 2008, the first quarter of FY 2009, or the third quarter of FY 2009. The cumulative number of compacts under this scenario ranges from 25 to 34.

### Assumptions Used in Our Analysis

For the higher-cost scenario, we assumed an average size of (a) \$300 million for compacts funded with MCC's FY 2006 appropriations and (b) \$345 million for compacts funded with its FY 2007 appropriations. These figures are consistent with recent MCC projections. For the lower-cost scenario, we assumed an average compact size of \$190 million. This amount is consistent with MCC's FY 2006 budget presentation and the actual average for the eight compacts signed or approved to date. For these compacts, MCC ranks among the top three donors in five of the eight countries and among the top 10 donors in the remaining three countries.<sup>4</sup> According to its FY 2005 and 2006 budget presentations and recent comments by the corporation's Chief Executive Officer, MCC seeks to be among the largest donors in each country that receives compact assistance. Table 1 summarizes some key characteristics of the compacts signed or approved from April 2005 through January 2006.

Table 1: Characteristics of MCC Compacts Signed or Approved, April 2005 to January 2006  
Dollars in millions

Country	Status	Month signed or approved	Total amount	Length (years)	Average amount per year	Donor rank
Madagascar	Entry into force <sup>a</sup>	April 2005	110	4	28	8
Honduras	Entry into force <sup>a</sup>	May 2005	215	5	43	5
Nicaragua	Signed	June 2005	175	5	35	10
Cape Verde	Entry into force <sup>a</sup>	July 2005	110	5	22	3
Georgia	Signed	Sept. 2005	295	5	59	2
Armenia	Approved <sup>b</sup>	Dec. 2005	236	5	47	3
Vanuatu	Approved <sup>b</sup>	Jan. 2006	66	5	13	2
Benin	Approved <sup>b</sup>	Jan. 2006	307	5	61	2
<b>Total</b>			<b>1,514</b>		<b>308.2</b>	
Average			189			

Source: GAO analysis of MCC records and data from the Organization for Economic Cooperation and Development.

<sup>a</sup>Signed compacts in which MCC and partner countries have negotiated additional agreements covering disbursement of funds, governance, procurement, fiscal and procurement agents, and other implementation matters.

<sup>b</sup>Compact approved by MCC Board of Directors but not yet signed by corporation and country officials.

For both scenarios, we assumed that over the next several years MCC would sign an average of two compacts per quarter—the actual rate observed. From April 2005 through January 2006, MCC signed or approved compacts with eight countries, or two compacts per quarter. This rate is the lower bound of the target range of two to four compacts per quarter established in MCC's FY 2006 budget presentation.

<sup>4</sup>To make this determination, we compared the average annual size of each compact with the gross official development assistance (average for 2003-04) provided by the top 10 donors in each country.

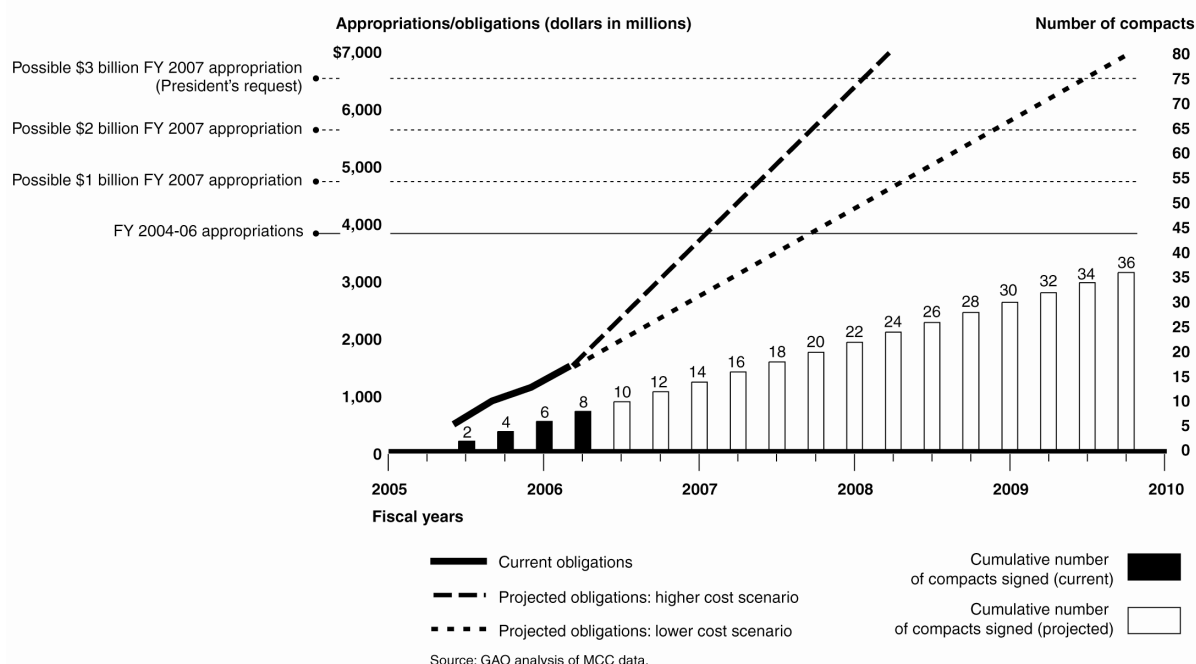
## Analysis of Future MCC Obligations

Under the higher-cost scenario, the corporation would obligate the balance of its FY 2004-06 appropriations by the second quarter of FY 2007. Assuming subsequent compact size remains consistent with MCC projections, an FY 2007 appropriation of \$1, \$2 or \$3 billion would fund compacts through, respectively, the third quarter of FY 2007, the fourth quarter of FY 2007, or the second quarter of FY 2008.<sup>5</sup> The cumulative total of compacts funded under this scenario would be 18, 20 or 23.

Under the lower-cost scenario, the corporation would obligate the balance of its FY 2004-06 appropriations by the fourth quarter of FY 2007 (or about 6 months later than under the first scenario). Again assuming that subsequent compact size remains consistent with the average to date, an appropriation of \$1, \$2 or \$3 billion would fund compacts through, respectively, the third quarter of FY 2008, the first quarter of FY 2009, or the third quarter of FY 2009. The cumulative number of compacts funded under this scenario would be 25, 30 or 34.

Figure 1 presents our estimate of MCC's cumulative obligations and number of compacts signed under these two scenarios, as well as MCC's obligations to date.

**Figure 1: Estimated MCC Obligations and Numbers of Compacts under Higher- and Lower-Cost Scenarios and Current Obligations as of January 2006**



<sup>5</sup>Our estimates assume that about 10 percent of the corporation's FY 2007 appropriations would be set aside for MCC's threshold country program, administrative expenses, due diligence, monitoring and evaluation, and other costs, leaving the remaining 90 percent to finance compacts.

## Some Implications of Our Analysis

Over the period covered by our analysis, the substantial expansion in the number of compacts—and thus the number of countries in which MCC would operate<sup>6</sup>—suggested by MCC’s current and target rates for signing compacts could present several challenges for the corporation. First, such an expansion could exhaust the pool of candidate countries that meet MCC’s quantitative eligibility criteria. Our analysis of MCC data suggests that 34 candidate countries—8 lower-middle income and 26 low income—met MCC’s FY 2006 quantitative indicator criteria. We previously reported that 19 and 24 low income candidate countries met MCC’s criteria in FY 2004 and 2005, respectively.<sup>7</sup>

Second, such an expansion could significantly challenge MCC’s ability to make eligibility determinations; review and assist in proposal development; conduct due diligence reviews; negotiate, sign, complete entry into force requirements; and assist in the development of compact implementation structures for a large number of additional countries. For the eight countries in table 1, an average of 484 days elapsed from eligibility determination to compact signing or approval. It took, on average, an additional 112 days for three of these countries to advance from compact signing to entry into force.

Third, monitoring and evaluating the implementation of complex, multi-million-dollar compacts in a large number of countries could strain MCC’s management and oversight capabilities. Several development experts have stated that MCC’s proposed staffing level (300) is very lean for an organization planning to disburse \$2 billion or more per year.

## Comments from MCC

Overall, MCC officials characterized our analysis as unbiased and fact based. With regard to the implications of our analysis, MCC officials stated that the corporation was taking steps to reduce the time required to develop, review, and start implementing compacts. These steps include (1) developing guidance to assist eligible countries in developing proposals that will require limited revision; (2) reducing the time required to conduct due-diligence reviews by increasing staffing and resources devoted to this task;<sup>8</sup> and (3) implementing policies intended to reduce the time between compact signing and entry into force by requiring MCC teams and countries to resolve key implementation details and issues earlier in the compact development process. Consistent with recent public remarks made by the corporation’s Chief Executive Officer, MCC officials recognized that implementing compacts in developing countries will present substantial challenges. MCC officials also provided updated information about projected compacts and several technical comments, which we have incorporated as appropriate.

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<sup>6</sup>Under the Millennium Challenge Act, countries may have only one Millennium Challenge compact in effect at a time.

<sup>7</sup>See U.S. Government Accountability Office, *Millennium Challenge Corporation: Progress Made on Key Challenges in First Year of Operations*, [GAO-05-455T](#) (Washington, DC: April 26, 2005).

<sup>8</sup>MCC plans to increase its staff from about 170 to 300 between January and September 2006.

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If you or your staff have any questions about this letter, please contact me at 202-512-4128 or [gootnickd@gao.gov](mailto:gootnickd@gao.gov). Phil Herr and Michael Rohrback made significant contributions to this letter.

Sincerely yours,

A handwritten signature in black ink, appearing to read "David Gootnick". The signature is written in a cursive, flowing style with a large initial "D".

David B. Gootnick  
Director, International Affairs and Trade

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