

**THE MILLENNIUM CHALLENGE ACCOUNT:  
DOES THE PROGRAM MATCH THE VISION?**

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BEFORE THE  
**COMMITTEE ON**  
**INTERNATIONAL RELATIONS**  
**HOUSE OF REPRESENTATIVES**  
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## **THE MILLENNIUM CHALLENGE ACCOUNT: DOES THE PROGRAM MATCH THE VISION?**

**WEDNESDAY, APRIL 27, 2005**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON INTERNATIONAL RELATIONS,  
*Washington, DC.*

The Committee met, pursuant to notice, at 11:29 a.m. in room 2172, Rayburn House Office Building, Hon. Henry J. Hyde (Chairman of the Committee) presiding.

Chairman HYDE. The Committee will come to order. Good morning and welcome to today's hearing of the Committee on International Relations.

In March 2002, in Monterrey, Mexico, President Bush laid out his vision for what would become the most fundamental shift in foreign development assistance in decades. Stating that pouring money into a failed status quo does little to help the poor, the President offered an alternative to the failure of past development practices. He proposed that the United States target larger levels of assistance to fewer countries that have demonstrated a commitment to good governance, open economies, and investments in their people.

Congress answered the President's call by enacting the Millennium Challenge Account (MCA) proposal into law in June 2003, appropriating \$1 billion for MCA activities in 2004 and \$1.5 billion in 2005. The great promise of the Millennium Challenge Account was met with tremendous hope and anticipation by the international community and the developing world. Its reach and influence has already motivated many countries to reexamine their governance, openness, and accountability in the hope to be accounted among those nations accepted into the program.

Today, we stand 37 months removed from Monterrey. The Millennium Challenge Corporation is now in place to administer the program, but the \$2.5 billion appropriated by Congress for helping the most deserving countries remains in the MCA Bank, and intentions to jump start this initiative in its early stages have long since dissipated. While we congratulate Madagascar for being the first to sign a compact just 9 days ago, the same observers who once received this initiative with such optimism now feel underwhelmed by the cautious pace and the modest scope of MCA writ large.

We recognize that development work is extraordinarily difficult, and we commend those in the Millennium Challenge Corporation for their long hours and dedication. But from the outside, we see a program struggling to get off the ground and funding levels for compacts now emerging that lack the boldness necessary to break

the cycle of poverty in countries prepared to take that step. Perhaps a series of \$100 million compacts are, by convention, right sized, and development strategies should never be reduced to a funding race among donors.

Realistically, however, such compacts are unlikely to provide the necessary clout to fundamentally change poor economies. At the end of the day, success will be measured by our capacity to spur fundamental improvements in the economies and poverty reduction of partner countries, not merely whether we had a program in place.

MCA's current scope also poses difficulties for the scale and sequencing of future Millennium Challenge Account funding. The President's request is to add \$3 billion in 2006 to the unspent \$2.5 billion from the past 2 years. This total would require the equivalent of 27 compacts, at \$200 million each, to be negotiated, approved, and signed in the next 20 months before the funds would be exhausted. Signing even half that number of compacts before the end of Fiscal Year 2006 would be a triumph over the current pace. Combined with the prospects of billions more coming on line in 2007, it seems that we have more funding than program. I would prefer that Congress be under pressure to catch up and fund a success than need to justify funding for a potential one.

Today, I ask our witnesses to offer their views on several issues. First, how many signed compacts will we have in hand before the end of this fiscal year and before the end of Fiscal Year 2006?

Second, if the MCC Board met on a defined, regular schedule, perhaps once a quarter, rather than on an as-needed basis, would it spur greater urgency for action in order to meet specific deadlines?

Third, what is MCC's strategy for handling poor performers, both before and after a compact is signed? Will the board have the diplomatic courage to remove lukewarm countries from the program? I look forward to hearing the responses from our witnesses to these concerns.

MCC should bolster the levels of assistance to countries that implement their compacts in a manner that reflects the vision of MCA to create major improvements in economic growth and poverty reduction. A 3- or 4-year compact, though significant, is not likely to achieve such a result, particularly at the funding levels we now see emerging.

MCA cannot become an open-ended commitment to partner countries, but we should consider awarding follow-on compacts of several hundred million dollars each to the four or five countries that demonstrate the greatest dedication to implementing their MCA compact and prove the most serious in their commitment to pursue the reforms necessary to create self-generated prosperity.

Let me be clear: Millennium Challenge is the most important development idea in a generation, and it must become the global model for helping the transformation of needy societies into communities of opportunity. The incremental approach and lack of urgency in the implementation of this initiative belies the original vision. I am concerned that it could create an eventual backsliding that will make MCA just another development program.

This Committee will seek to reauthorize the Millennium Challenge Account before the current authorization expires at the end of this year, and we look forward to working with the Administration to ensure its place next to the Marshall Plan in its historical significance.

I now turn to my friend, Tom Lantos, Ranking Democratic Member, for his remarks.

Mr. LANTOS. Thank you very much, Mr. Chairman, for calling this important hearing and for your leadership on this whole issue, and I want to identify myself with your very thoughtful and serious comments.

Mr. Chairman, 3 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. This morning, we shall answer the question of whether this program is living up to its important mandate.

Mr. Chairman, you and I have been champions of the Millennium Challenge Account from the beginning, and we remain so, but our support is now in jeopardy. Unless the Millennium Challenge Corporation gets its act together and gets it together quickly, support for the Millennium project will evaporate.

Between the program's founding vision and its meager results thus far, there is a vast gap. The lack of progress could just be chalked up to the growing pains of a new program, but it is also possible that the program needs much more congressional guidance to keep it true to its potential.

We are all pleased with the signing last week of the first Millennium compact with Madagascar, but I am not convinced that the corporation is up to the task of substantially reducing poverty through increased economic activity for the poor.

I have three primary concerns in this regard, Mr. Chairman: First, the very slow pace at which available funds are disbursed; second, a clear need to do more to engage people at all levels in the receiving society; and, third, the funding of costly infrastructure projects over health and education efforts. Let me elaborate on each of these three items.

First, the lofty goals of the Millennium Challenge Account will be for naught if the funds that Congress has approved continue to sit in Washington unused, instead of finding their way into the calloused hands of men and women in villages across Africa, Asia, and Latin America. Mr. Chairman, Congress has appropriated \$2.5 billion to the Millennium project, but eligible countries have yet to receive one thin dime of this amount.

After Madagascar was designated one of the lucky 16 countries to receive funds last May, it took nearly 1 year for the Millennium Corporation to conclude the Madagascar Compact. Compacts with the next four eligible countries—Honduras, Nicaragua, Georgia, and Cape Verde—have not yet been signed either.

According to one of our witnesses today, the corporation may not have hired enough staff to do the job. The World Bank, the Ford Foundation, and the British Foreign Aid Agency have approximately 10 times as many staff per billions of dollars in assistance as does the Millennium Corporation. This staffing level must be evaluated and, if necessary, rectified. None of us want global bu-

reaocracies, but we also do not want a staff which is palpably insufficient to get the job done.

Secondly, Mr. Chairman, I wonder if the Millennium Corporation is up to the task of ensuring a sense of ownership in each country that takes part in the Millennium program. I have received troubling reports out of Madagascar, Mozambique, and Honduras about how Millennium Corporation staff, in laying the groundwork for participating in the program, have not ensured that the governments of eligible countries have reached out to a broad spectrum of student and women's groups, farm co-ops, religious organizations, and labor unions. Instead, they have relied primarily on business associations to generate ideas for development.

Mr. Chairman, when our staff traveled to Madagascar to investigate the status of our Millennium negotiations, they met with representatives from the 20 leading, non-governmental organizations in that country. Only one of these NGOs had been consulted by the Government of Madagascar in the crafting of its economic-development proposal to the United States. While I presume that other organizations may have been included, it strikes me as a glaring omission that key elements of civil society were left out of the discussions.

When our staff traveled to Mozambique and was shown a potential project to be funded by the Millennium Corporation, the primary investors were South Africans, Portuguese, Germans, and French, who then had the audacity to propose a health clinic separated between foreigners and locals.

Third, I wonder whether the Millennium Challenge Corporation is up to the challenge of seriously tackling poverty in developing countries. A review of the one completed compact and the proposed compacts for other countries does not bode well. Nearly 20 percent of Madagascar's compact is programmed initially to benefit the richest 1 percent of Madagascar society.

The compact will fund a financial services project that is meant to reduce the amount of time it takes to get a check cleared, but only 208,000 of Madagascar's total population of 17 million currently have bank accounts. In light of these statistics, why can't the large foreign banks operating in Madagascar share a portion of the cost for this project?

Mr. Chairman, it is disappointing to note that the program has failed to realize its promise thus far, but this important initiative can, and must, be put back on track. Our negotiators must accelerate our deals with Millennium countries so money can begin flowing. A broad spectrum of leaders in the developing world must be consulted on how our Millennium money will be spent, and we can find ways to fund education and healthcare while encouraging the private sector to assume a greater burden of infrastructure projects.

Mr. Chairman, I know this is a tall order, but I also know how the President and Congress intended the program to be implemented. Let us get it done right so that next year we will have nothing but good news to celebrate. Thank you, Mr. Chairman.

Chairman HYDE. Thank you, Mr. Lantos.



The Chair would like to get to the testimony; however, I will recognize Members for opening statements of 1 minute, should they feel compelled to make one. Mr. Rohrabacher?

Mr. ROHRABACHER. Very quickly, we are fully aware that no matter how much money we provide certain countries to try to help them, unless they have actually reformed their ways of doing things, that money would be a waste. So we are looking very carefully at that. The amount of money is less important than the actual reform that it generates. Thank you very much.

Chairman HYDE. Thank you. Anyone else?

[No response.]

Chairman HYDE. Very well. I would like to welcome Mr. Paul Applegarth, the Chief Executive Officer of the Millennium Challenge Corporation. Prior to his confirmation in May 2004, he was Managing Director of the Emerging Markets Partnership, an asset-management firm specializing in emerging markets. He was also CEO of the Emerging Africa Infrastructure Fund, Chief Financial Officer of United Way of America, and served in the U.S. Army in Vietnam.

Mr. Applegarth, we are honored to have you appear before our Committee. If you would proceed with a 5-minute summary of your statement, your full statement will be made a part of the record. Mr. Applegarth.

**STATEMENT OF THE HONORABLE PAUL V. APPLGARTH,  
CHIEF EXECUTIVE OFFICER, MILLENNIUM CHALLENGE  
CORPORATION**

Mr. APPLGARTH. Thank you, Mr. Chairman. I will give you a brief summary of that statement and, in the interest of time, would like to address some of the issues that both you and Congressman Lantos raised in your opening statements.

First, I want to emphasize that we are grateful for the bipartisan support of this Committee, which, under your leadership and that of Ranking Member Lantos, were champions in creating and sustaining the MCC, and as you know, I believe sustaining and building on that bipartisan support is an important part of my job.

MCC is built on a common-sense idea: Foreign aid yields better results when it is invested where it will be used well, i.e., in countries that put in place policies that support poverty reduction and economic growth, policies such as good governance, investment in health and education, and in enabling an environment for entrepreneurs. The President has requested \$3 billion in funding for Fiscal Year 2006 for the MCC to reduce poverty. It will be a strong incentive for policy reforms.

A \$3 billion appropriation ensures that MCC can credibly tell our partner countries that we can fully fund compacts that reduce poverty and spur economic growth. It is critical for MCA-eligible countries to recognize that the U.S. will live up to its monetary commitment, and the \$3 billion request helps us make such assurances.

My presentation today will focus on three areas: The need for the \$3 billion; the progress we are making in existing country proposals and the strength of our current pipeline; and the steps we are taking to accelerate progress. Thus far, we have received country proposals totaling more than \$4.5 billion. Through due dili-

gence, elimination of items that do not show a strong link to poverty reduction and do not appear to arise from an adequate consultative process, and deferral of things not yet ready, that \$4.5 billion has been reduced to around \$3 billion. However, this does not include the likely proposal from Morocco, which is expected to be fairly large.

Our current estimate is that the amounts required to fund the proposals from existing eligible countries will exceed the resources currently available for Fiscal Year 2004 and Fiscal Year 2005 appropriations by at least a billion dollars. In addition, out of the Fiscal Year 2006 appropriation, we will need resources to fund new, low-income eligible countries, lower-middle-income countries, which will be candidates for MCC funding for the first time, and new threshold countries.

To approach the problem from another perspective, the Government Accountability Office found that the funding awarded from existing appropriations would only allow MCC to fund between 4 and 13 compacts. In contrast to this minimum of 4 and maximum of 13, MCC now has 17 eligible countries. To state it succinctly, if we are to achieve the original goals and transformational effect envisioned for the MCC, we need to be adequately funded.

Let me now turn to the status of our current pipeline. I am both pleased and proud to report that MCC has made substantial progress since I testified before you last May. Our most notable achievement was the signing last week of our first compact with Madagascar for just under \$110 million. The Madagascar Compact marks an important step forward for the MCC but is only the beginning.

There are many countries working hard for the opportunity to sign a compact. In addition to Madagascar, MCC has already notified Congress of our intention to negotiate compacts with Honduras, Georgia, Nicaragua, and Cape Verde. Subject to successful negotiations, positive due diligence results, and board approval, we hope to sign compacts with all of them this summer.

Honduras is up next, with its \$208 million program to be considered by MCC's board on May 20th. We also have a robust pipeline of countries in varying stages of compact development. The chart to my right shows our most recent update, including the time required for due diligence, compact negotiation, board approval, and congressional consultation. The country names have been redacted, as these are ongoing negotiations with foreign governments and represent our internal management assessment of where we are with each. The first five countries on the chart are those in active compact negotiations with MCC, including Madagascar, which has, of course, already signed.

While this is a fluid document, as it is an internal management tool that is revised frequently, it gives you a sense of how we are managing the compact pipeline. My staff and I can also brief you and your staff in a more confidential setting about how we are progressing with each of the countries underlying this chart, some specific concerns we are addressing, and when we hope to sign a compact, et cetera. In terms of sectors, these country proposals reflect recurring themes: Rural development, agricultural, land tenure, fi-

nancial sector reform, private sector development, and infrastructure.

We are confident that the completed compacts with our eligible countries will yield real results; real results that are measurable. In fact, MCC has already obtained results, even before spending money. We are strengthening the hands of reformers to accomplish important changes. Governments have consulted with their citizens, some for the first time. Since the announcement of MCA indicators in February 2003, the medium number of days to start a business has dropped from 61 to 46 in MCA-candidate countries.

Many countries have targeted corruption, a primary MCC indicator. Bangladesh's finance minister, while proposing a tough program targeting corruption, cited his country's exclusion from the MCA as an example of the heavy price he is paying for being branded a corrupt country. One official from an eligible country said that even if he received less aid than requested, the intangibles gained from taking control of their own development destiny are the most important part of the process.

Finally, I want to take this opportunity to address some questions that you both raised and from others regarding the MCC timeline. MCC's mission differs from many other assistance efforts. In disaster relief and in many humanitarian-assistance programs, the diagnosis of the problem and the solution are relatively straightforward to determine and execute, i.e., rescue the people in danger; feed and house them.

MCC's task is fundamentally different, the problems are more intractable and the solutions less obvious. Identifying the real reasons for grinding poverty and finding answers that will lead to poverty reduction and long-term growth requires serious consideration and thoughtful effort.

In addition, our partner countries are leading this effort for the first time. They do not want quick fixes; they want help making structural, long-term changes in their countries that will reduce poverty. We do help, and together we must identify the objectives, determine what results the countries want and how they will be measured, and develop detailed implementation plans that incorporate transparent procurement procedures, fiscal accountability, and donor coordination.

We all wish you could make real, sustainable change happen faster. No one is more impatient than I am in terms of getting commitments, compacts signed, and funds disbursed, though we cannot move too fast, or you end up with a failed program. We have seen that happen too many times, and we have already seen the value of this rigorous process. A nonpartisan observer described our Madagascar program as "a rare example of a development agency doing virtually everything right."

While I prefer to describe it as an example of one of our partner countries doing virtually everything right, the point is clear: Identifying obstacles to growth, consulting broadly, focusing on measurable results, and doing detailed planning in advance take time but lead to a better result.

I want to emphasize that preserving country ownership does not mean that countries are left without assistance during compact development. We do not sit passively by, waiting for countries to act.

Poverty is an urgent matter. We do many things to speed up the completion of country plans. We want to do things right, but we do want to do things right fast, and, I think, if you look at the standard of processing and compact development at MCC and compare it to any comparable institution, public or private sector, it is something that you can take pride in.

Even before a compact is signed, MCC is using funding and disbursing, under 609[g] of its legislation, to implement projects that will speed up compact implementation after signing, for example, to gather baseline data in Madagascar and Nicaragua and to fund an environmental impact study and a preliminary engineering design in another country.

The MCC has the potential to accomplish a great deal in the struggle to reduce poverty. The MCC impacts the poorest people in the world, people who live on less than \$2 a day. We have an opportunity to reduce poverty in some of the poorest countries of the world, and we have a responsibility to the American people to invest their money wisely. We take these responsibilities seriously.

Let us not forget, MCC and international development are not only about bringing the best of America to our relationship with the world but are a key component of U.S. national security. As the 9–11 Commission recommended, “A comprehensive U.S. strategy to counter terrorism should include economic policies that encourage development, more open societies, and opportunities for people to improve the lives of their families and to enhance prospects of their children’s futures.”

This, of course, is the mission of the MCC. By lifting countries out of poverty and providing people of the world’s poorest nations a stake in their future, these countries will less likely be havens for terrorists. The most recent country selections mean that MCC has relationships with 30 countries, totaling 400 million people. By focusing our efforts on countries that rule justly, invest in their people, and promote economic freedom, we can help the world, one country at a time, if we have the adequate resources.

I would be pleased now to take your questions, and thank you very much.

[The prepared statement of Mr. Applegarth follows:]

PREPARED STATEMENT OF THE HONORABLE PAUL V. APPLGARH, CHIEF EXECUTIVE OFFICER, MILLENNIUM CHALLENGE CORPORATION

Mr. Chairman, members of the committee, thank you for this opportunity to appear before you again as the CEO of the Millennium Challenge Corporation (MCC). I am grateful for the bipartisan support of the members of Congress in creating and backing the MCC, and I hope to strengthen that bipartisan coalition. I am pleased to have much to report since we met in May 2004.

Today, I want to focus on topics that I believe concern this Committee and describe our activities since we last met.

The President has requested \$3.0 billion in Fiscal Year 2006 funding for the MCC to help reduce poverty through measurable results and preserve the strong incentive for positive policy reforms throughout the world. A \$3 billion appropriation ensures that MCC can credibly tell our partner countries that we are ready, and able, to fully fund Compacts that show a real commitment to reducing poverty and spurring economic growth. It is critical for Millennium Challenge Account (MCA) eligible countries to recognize that the U.S. is committed to funding good proposals, and the \$3 billion request helps us make such assurances.

The amounts in the original concept papers and Compact proposals totaled roughly \$4.5 billion. Through due diligence, elimination of items that did not contribute sufficiently to poverty reduction and growth, components that did not appear to

arise from an adequate consultative process, and phasing of items that might unduly delay an initial compact, that total has been reduced to around \$3 billion. However, that amount does not include Morocco's proposal, which, given the size of the country, is expected to be fairly large. In short, proposals from eligible countries already are expected to exceed resources currently available by about \$1 billion. In addition, MCC estimates that the addition of new FY 2006 candidate countries, along with amendments to existing compacts, will increase the total requests from MCA-eligible countries by as much as \$3 to \$5 billion in FY 2006.

As you are aware, on January 23, 2004, the MCC was established to administer the MCA, an innovative new foreign assistance program designed to more effectively focus U.S. development assistance on poverty reduction.

MCC is built on the common sense idea that foreign aid yields better results when invested where countries have put in place policies that support poverty reduction and economic growth—policies such as good governance, investment in health and education and an enabling environment for entrepreneurs. Indeed, MCC is about helping these countries help themselves.

In addition, MCC and international development assistance are not only about bringing the best of America to our relationship with the world, but as a key component of U.S. national security, as the 9/11 Commission Report recommends: "A comprehensive U.S. strategy to counter terrorism should include economic policies that encourage development, more open societies, and opportunities for people to improve the lives of their families and to enhance prospects for their children's future."

When I met with you in May 2004, MCC had been in existence for less than one year, yet had significant milestones to report. Candidate countries had been identified, and the Board had already selected the first 16 eligible countries to submit proposals for funding.

By mid 2004, less than eight weeks after MCC's Board had selected them, MCC teams had visited all 16 of our eligible countries. We are continuing to spend time on the ground in virtually every country and I can assure you that considerable progress is being made.

We count among our recent accomplishments the MCC Board of Directors approval of our first Compact with the country of Madagascar for just under \$110 million. The MCC Compact signing ceremony with the Republic of Madagascar was scheduled for April 7, but due to the attendance of Secretary Rice and Malagasy President Ravalomanana at the funeral of Pope John Paul II, we had to reschedule it for April 18th.

The Madagascar Compact marks an important step forward for the MCC. But it is only a beginning. There are many more countries working hard for the opportunity to sign a Compact. There are hundreds of millions of lives that we are in a position to improve, provided we have adequate means.

We have already notified Congress of our intention to negotiate Compacts with Honduras, Georgia, Nicaragua, and Cape Verde, and—subject to successful negotiations, favorable due diligence results and Board approval—we hope to be in a position to sign Compacts with each of them by this summer. In short, while it is difficult to be precise about our schedule, we anticipate that Compact approvals will proceed at a rapid pace.

To that end, we are also working hard on the Compact Proposals from the rest of the eligible countries that have submitted proposals. We are asking: What is the link to poverty reduction and growth? Who are the beneficiaries? How do you rank your priorities? How does this relate to what other donors are doing? These eleven countries are still working to be in a position where the United States can confidently make an investment, and we are helping them get there.

We are generally pleased with the quality and content of many of the Compact proposals we have received. Several countries moved quickly into effective program development with MCC. Other MCA-eligible countries, however, were initially unfamiliar with the new approach and have taken longer to develop effective programs which MCC can support. MCC has adhered to the principles of country ownership, while neither pushing money out the door, nor meeting artificial deadlines for signing Compacts. However, country ownership and responsibility does not mean that MCC abandons countries to work on their own. Rather, MCC has been proactively helping eligible countries to design workable programs with detailed plans for monitoring and evaluating performance, fair and transparent procurement procedures, fiscal accountability and donor coordination.

While the concept of preparing their own development proposals was not entirely new to some of these countries, many eligible countries are accustomed to having donors set priorities, design programs, handle implementation, procure goods and services, and manage most other aspects of these activities. Not surprisingly, these

countries initially looked to MCC to do the same. Other countries produced “laundry lists” of projects which had been left on the shelf from earlier donor programs.

In certain instances, eligible countries were informed that the initial proposals required greater involvement from other stakeholders in the countries’ development process, such as civil society, academia, and the private sector. In other cases the proposals needed more work in defining the planned poverty reduction impact.

Specific problems have also surfaced in developing key components in the proposals, sometimes reflecting a shortage of institutional capacity to put a comprehensive proposal together. In such cases, MCC has worked with the countries to develop that capacity locally. It is a process that has taken patience and diligence on both sides to ensure that the proposal is the final product of the eligible country’s decision-making, while MCC supports each country to move the process along as rapidly as possible. MCC continues to explore ways to facilitate faster, better Compact development by MCA-eligible countries consistent with the principle of country ownership, such as more extensive use of Compact development assistance under Section 609(g) of the Millennium Challenge Act.

The result is that MCC has a robust pipeline of countries in varying stages of Compact development, many of which will be finalized during the remainder of 2005. In our review of these proposals we have identified several recurring themes: rural development, agriculture and irrigation, land reform and tenure, financial sector reform, and private sector development.

As discussed above, the current total of the sixteen Compact proposals we have received from FY04 eligible countries (we are still waiting for a proposal from one 2005 eligible country, Morocco) is currently around \$3 billion. In order to fulfill these valid requests we need more funds to do it. If the MCC is going to be able to fund our currently eligible countries, select additional eligible countries, select from the new category of lower middle-income countries eligible for the first time in FY06 as provided in our legislation, as well as fund our Threshold countries, there is a strong need for fully funding the President’s request.

The concepts behind the MCC are bold and, as a package, unique. More importantly, they make sense for U.S. development assistance and for the countries we are helping. In 2004, the United States government created MCC as an alternative to what has previously been done in the field of foreign assistance. The Millennium Challenge Corporation has the potential to accomplish a great deal in our steadfast struggle to reduce poverty. MCC impacts the poorest people in the world, people who live on less than \$2 a day, those without access to clean water, without access to basic health care, those who suffer through disease and drought, and have no way to sustain themselves. The MCC was created to help to these people.

Through the years, the United States and others have devoted considerable funding to alleviating the effects of global poverty. Regrettably, however, there is far too little to be seen in terms of poverty reduction in relation to dollars spent. The MCC offers a new development assistance approach that requires measurable results for aid investment. We have learned that simply giving large sums of money away without quantifiable targets is not the most productive means of providing foreign assistance.

We know now that money is best spent on those countries that rule justly, invest in their people, and encourage economic freedom. This is the environment that can use the goodwill of the United States and translate it into sustainable economic growth. The MCC was established to make this happen in the poorest countries in the world.

Investing is always a risk when a measurable and positive outcome is desired. Bill Gates said that “giving money away is a far greater challenge than earning it.” The MCC has eagerly accepted this challenge. We have taken on the responsibility of helping fortify the desired results and of assisting in the measurement of them—we expect the United States will be proud of the results we achieve.

In fact, the success of the MCC has already begun, as our role in the foreign assistance arena has yielded results even before spending money. Early indications tell us that our process is working. Morocco and Vanuatu have consulted NGOs and the business sector for the first time. The MCA incentive has also prompted reform; anecdotal evidence points to a strong MCA role. One country, for example, passed four pieces of anti-corruption legislation and began enforcement, in the hope of receiving MCC assistance. Since the announcement of MCA indicators in February 2003, the median number of “days to start a business” dropped from 61 to 46 in MCA candidate countries. Many countries have targeted corruption—a primary MCC indicator—and are making strides to reduce corruption within their governments. Bangladesh’s finance minister, Saifur Rahman, while proposing a tough program targeting corruption, cited his country’s exclusion from MCA eligibility specifically as an example of the heavy price his country was paying for being branded

a corrupt country. One official from an eligible country said, “even if we receive less than requested, the intangibles gained from taking control of our own development destiny are the most important part of the process.”

MCC believes in country ownership. We believe that countries, no matter how poor, should have the opportunity to create a real program of economic growth for the benefit of their country—reflecting their priorities which address the needs of the people of their country—not just their government’s or ours. Countries maintain their autonomy while working with the MCC and, through mutual effort, a Compact takes shape.

Yet the MCC does more than provide assistance; it disseminates and encourages democratic ideals. The monetary incentive of the MCA is incredibly powerful. When a respectable but weak country is provided the means to grow and develop, the national security interests of the United States are better protected.

The MCC has great responsibility. We have a responsibility to reduce poverty in some of the poorest countries of the world and we have a responsibility to the American people to invest their money wisely with achievable positive results. We take these responsibilities seriously and we thank you for supporting us thus far.

While exactly how much we will obligate is driven by country priorities and pace of development and is contingent upon the MCC review process, provided our due diligence supports requests made in the Compact proposals and our Board approves, we expect to commit most of our current funding by the end of this calendar year or early in 2006.

The requests that we have on hand exceed the \$2.5 billion appropriated thus far. From those resources the MCC also needs funds for Threshold countries, expenditures for due diligence on the proposals themselves, a small portion for administrative expenses, and for compact development.

MCC also has the authority under provision 609(g) of its legislation to make disbursements to eligible countries to facilitate development and implementation of the Compact.

Our Compacts are implemented over three to five years, but, as directed by Congress, we obligate all our money up front and disburse as needed based on quantifiable benchmarks. This is part of the strength of the MCA and what will make us especially effective. Up-front monetary commitment helps motivate and support policy reform, assures all countries involved that substantial development progress can be made, that programs can be administered effectively, and that poverty will be reduced.

I would like to update you on the status of our Threshold Country Program. As you are aware, the Threshold Program is designed to support those countries that do not qualify for MCA assistance, but are close and have demonstrated a commitment to undertake the policy reforms necessary to improving their growth conditions and their prospects for qualifying for the MCA. In cooperation with USAID, we are currently working with thirteen Threshold countries. Seven Threshold countries were chosen in September 2004 and were given a January 31 deadline to submit concept papers. Six more were chosen in November and were given a March 15 deadline. All thirteen met the deadline and submitted concept papers.

Eight of the proposals are in excellent shape and we have suggested to these countries that they work on their detailed implementation plans and determine the results—quantifiable results—they will generate out of the programs. That work has started.

Five of the Threshold countries’ proposals do not yet meet MCC standards. We have given these countries an additional 60 days to improve their proposals. We and USAID are working very hard with these countries to give them as good an opportunity as possible.

I also want to take this opportunity formally to address and respond to comments I have heard regarding the MCC timeline—specifically the notion that MCC has been off to a slow start.

The Millennium Challenge compact development process (Appendix 1) is thorough and it has never been done. As a point of reference, in the private sector, when an investment proposal is received, the parties have been through the process before, the objectives are known (e.g., financial return or credit-worthiness) and the management organization and implementation plan are known.

In contrast, the MCC and our countries are going through this process for the first time. Together we must identify our objectives, how we will measure results, and work to develop detailed implementation plans. We do not want the efficacy of the mission to be reduced because we are rushing to meet artificial deadlines or rushing money out the door. We want to do things right and we want to do them right the first time. But we also want to do the right thing fast.

My experience has taught me that you are doing well in the private sector if it takes only four to five months from the time a sound and well supported proposal is received until an investment is made—and I am sure many of you can attest to this. I am told the World Bank takes an average of 18 months to make a lending decision. We received the first draft of Madagascar's Compact proposal in October 2004. In only six months, Madagascar and the MCC have succeeded in creating a workable Compact that will reduce poverty through economic growth. Certainly, this is a good accomplishment by any standard.

Preparing a proposal is a new approach for our partners. Part of the novelty of MCC's approach is that if governments create a pro-development policy environment, they are given a significant amount of responsibility in establishing projects and goals, focusing on outcomes, and ensuring community responsibility. And we are actively working with them to develop the best possible proposals as fast as possible. This takes time, but we encourage our countries to take the time to create an excellent proposal, then work with them to develop a program as quickly as possible.

For example, we are using the 609(g) authority in connection with the Madagascar Compact to provide some initial funds to do baseline data collection to facilitate Compact implementation. The lack of available data and local capacity to collect statistics in rural areas poses significant timing challenges for measurement of the program. This use of 609(g) funds will substantially accelerate the implementation of program activities and the establishment of measurable outcome targets.

Also, MCC teams make frequent trips to eligible countries to work with our partner's teams there. In several recent weeks, we have had teams in five different countries each week.

MCC engages engineers and consultants to help refine country plans following proposal submission; in addition to providing our own funding and resources, we have arranged with UNDP to set up a capability to fund some items, if requested by countries.

MCC has identified "Lessons Learned" from Madagascar and other countries that are more advanced in Compact development, and is holding meetings and seminars with other countries, including:

- A Washington seminar for all Ambassadors to the U.S. from eligible countries
- Outreach with a similar message to U.S. Ambassadors and USAID mission chiefs during country visits.

In addition to formal seminars, we meet regularly with government officials from MCC countries visiting Washington, to focus on solutions to current obstacles in the process, and on next steps.

MCC's website is regularly updated with Compact guidelines (in seven different languages) and other useful information, and the Madagascar Compact will be posted as an example as soon as it is signed.

The Millennium Challenge Corporation is not a quick-fix to poverty. We put substantial time into Compact development and review to ensure that the U.S. investment will make a definitive and positive impact on the poorest countries in the world. We are fiduciaries of the money Congress has appropriated. We remain committed to making sure the American taxpayers' investment is used wisely.

Because Madagascar was the first eligible country to sign a Compact, I would like to briefly expand on it.

Years of instability have left it one of the poorest countries in the world. Out of a population of almost 17 million, over 80% live on less than \$2 a day. When the UN ranked countries on the Human Development Index—or better 'Human Misery Index'—Madagascar ranked at the 85th percentile as one of the very poorest countries. However, in the last two years Madagascar has demonstrated a strong commitment to good governance and social investment. The government is implementing wide-ranging, anti-corruption, financial management and judicial reform policies.

Poverty in Madagascar is overwhelmingly rural. Its agriculture productivity is among the lowest in the world. Seventy-three percent of Madagascar's population live in rural areas; eighty percent of those who live under the poverty line are rural inhabitants. In this situation, the most effective vehicle to reduce poverty is for the rural poor to invest in their land, to plant new crops, to learn how to increase productivity, to improve farming methods, to get credit to implement these new methods and, finally, sell to new markets.

Consequently, the Government of Madagascar asked MCC to support a major effort to attack two of the root causes of poverty: first, a weak land-titling system that fails to provide the incentive or collateral for investments in poor rural areas, and second, a dysfunctional financial system that fails to serve the rural poor.



The Malagasy people believe that reforming the broken-down land-titling system will give them clear rights to their property and the ability to borrow against it, the best asset they have to improve their lives and those of their children. Improved property rights will also help reduce the incentive to engage in environmentally destructive practices, such as slash-and-burn land clearance.

In developing these concepts, the Government of Madagascar engaged in consultation focused on developing commitment around a sound program for consideration by MCC. A national workshop was organized in September 2004 to discuss the obstacles to growth and poverty reduction consisting of more than 350 participants, including President Ravalomanana, to describe the MCA and discuss obstacles to economic growth and poverty reduction.

The Government of Madagascar then organized six regional consultative workshops, each consisting of 50 to 150 representatives of the business community, non-governmental organizations, civil society and donors in all the provincial capitals. The Government also ran radio and TV broadcasts about the MCC, and published newspaper ads that announced meetings and called for submissions of ideas from all segments.

The *Land Tenure Project* of the Compact will formalize the titling and surveying systems, modernize the national land registry, and decentralize services to rural citizens. *The Financial Project* will make financial services available to rural areas, improves credit services, and create a streamlined national payments system. *The Agricultural Business Investment Project* will help farmers and enterprises identify new markets and improve production technologies and marketing practices to sell to new markets.

To the credit of the Malagasy, they have proven to be excellent partners in designing systems and procedures that provide the proper controls and safeguards over the use of MCC funding.

Accordingly, the Malagasy will engage a professional firm to control funds, manage cash, and oversee accounting and procurement services. The Madagascar Steering Committee will select this firm as a result of a competitive process that is already underway. Our agreement with Madagascar also requires regular independent audits, and we will conduct our own on-site reviews over the course of the Compact.

The MCC project development, due diligence, and implementation supervision process requires in-depth design, expertise, resources, and time. After the MCC received legislative approval in January 2004, we started with a staff of seven detailed employees. We now have between 110 and 120 people, plus detailees and PSC'S, and we're on plan to reach to our target number of 200 staff by the end of 2005. Talented staff have come from within the government, the private sector, universities, non-governmental organizations, and international institutions. That has taken a fair amount of our time, particularly because we need highly skilled people with specific qualifications.

As we move forward with our other compact negotiations, we are seeking input on a Natural Resources Management indicator from a broad range of natural resource experts from academia, think tanks, and NGOs. Furthermore, we have an ongoing and active dialogue with these groups and institutions about MCC operations and policy matters of mutual interest. We are grateful to them for their support and their constructive feedback on issues such as the consultative process. In fact, with regard to that issue, these groups have even mobilized their partner groups in countries to engage in the consultative process and to provide us feedback, which we greatly appreciate.

I would like to conclude my remarks today by putting the President's request for \$3 billion in context.

The Government Accountability Office found that, using data on MCA-eligible countries, MCC would need to have total resources of roughly \$3.4 billion to be one of the top three donors in eight to fourteen countries. In other words, to have the impact of one of the top three donors in eligible countries, MCA programs would need to be on the order of \$250 million per country on average, based on three-year Compact programs; five-year programs would require proportionately greater funds. This analysis, combined with our experience to date, forms the basis for our projections. (Appendix 2)

MCC must focus its available resources to fulfill its mission of supporting transformative development programs. MCA is intended to provide a significant policy incentive to candidate countries by commanding the attention needed to galvanize the political will essential for successful economic growth and sustainable poverty reduction, and needs substantial resources to have that incentive effect.

Appropriations below \$3 billion for FY06 will most likely require reductions in the number or scope of MCC Compacts, and/or force the MCC to forego funding good

proposals. Such reductions would undercut MCC's effectiveness in having a significant impact on poverty reduction and economic growth.

Moreover, for FY06 and beyond, up to 25 percent of the funds appropriated for FY06 can go to Lower-Middle Income Countries as specified by our legislation. Therefore, there will be two competitions: one for lower income countries and one for lower-middle income countries. This will further increase the demand on limited MCC funding.

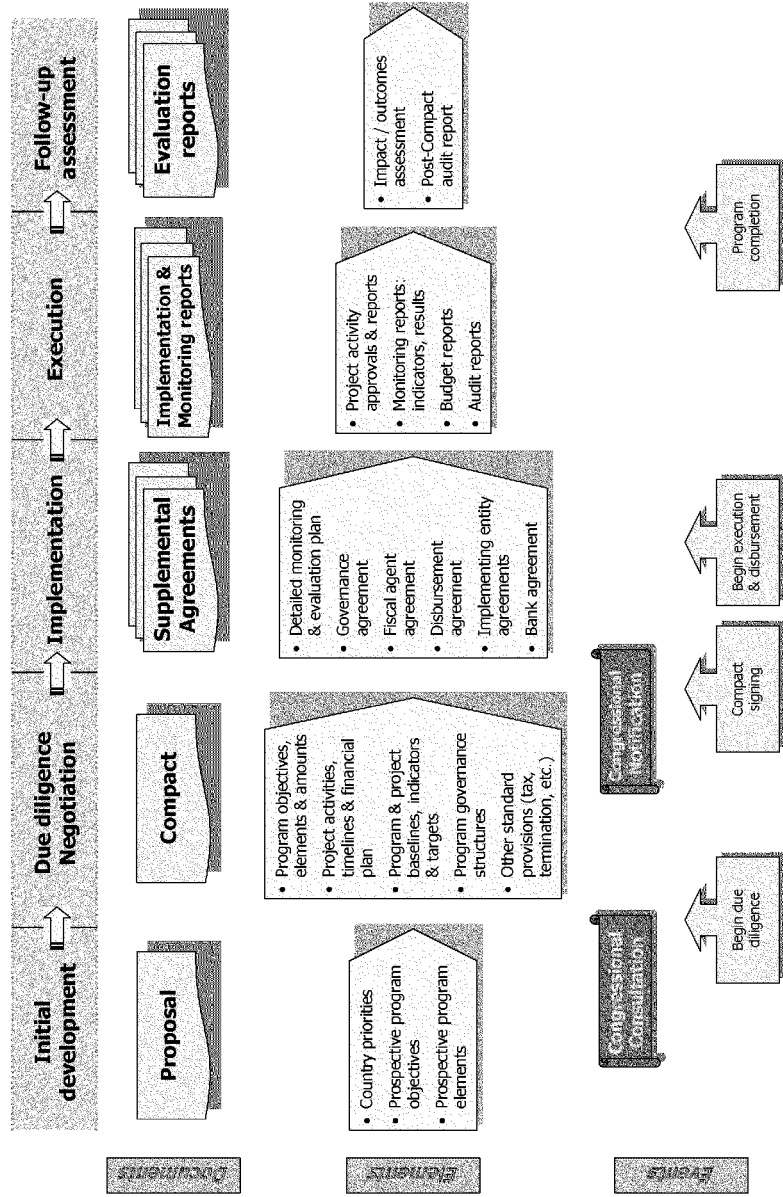
We are deeply appreciative of your support thus far and are grateful to have had the opportunity to begin our mission. There is much more work to be done, however. To make significant progress in reducing poverty we need to uphold the commitment made by the United States. Now is an opportunity to reaffirm that the United States is serious about reducing poverty on a global level.

The most recent country selections means that the MCC is in a position to have potential relationships with as many as 30 countries—some of the poorest in the world—totaling 400 million people. By focusing our efforts on countries that rule justly, invest in their people, and promote economic freedom, we can help the world, one country at a time. This will be beneficial for those countries, for the impoverished people living in them and for the United States.

I want to end by thanking the committee, which under the leadership of Chairman Hyde and Ranking Member Lantos has given the MCC true bipartisan support, which has been vital to our accomplishments so far, and which will be even more vital for our future success.

I welcome any questions you might have.

MCC Process Overview



## CONGRESSIONAL BUDGET JUSTIFICATION SUMMARY

	Funding FY 2004 / FY 2005		Funding FY 2006	
	Number of transactions	Average Amount Totals (\$ Millions)	Number of transactions	Average Amount Totals
Low-income countries	12	2,278	6	291
Amendments to earlier Compacts	-	-	3	100
Low-middle income countries	-	-	4	170
<b>Total Compacts and Amendments</b>	<b>12</b>	<b>2,278</b>	<b>13</b>	<b>2,725</b>
Threshold Programs		130		140
<b>Total Assistance</b>		<b>2,408</b>		<b>2,865</b>
Administrative expenses		55		85
Due Diligence/Monitoring & Evaluation		17		48
Audit Expenses (Inspector General-USAID)		2		2
Rescissions – FY 2004 and FY 2005		18		-
<b>Total Administrative, Due Diligence, M&amp;E</b>		<b>92</b>		<b>136</b>
<b>Total Obligations</b>		<b>2,500</b>		<b>3,000</b>

Chairman HYDE. Thank you, Mr. Applegarth.  
Mr. Lantos?

Mr. LANTOS. Thank you very much, Mr. Chairman. I want to thank Mr. Applegarth for his testimony. I have a few quick questions, and I would be grateful for your responding to them, if I may.

As I understand it, the final two members of the MCC's board of directors have not been nominated yet. I would like to know, when does the White House plan to submit names to the Senate for consideration and confirmation?

I would like to know, since your written testimony finds that the MCC board has not completed a comprehensive strategy or plan for carrying out its oversight responsibility, when does that body plan to establish, minimally, an audit committee and other bodies that will evaluate the program?

I would like to find out what, in your view, has been the nature of civil society participation in the development of compact proposals, and if I may, I would like to get some idea of how the relationship is unfolding between your organization and USAID. Should USAID missions be terminated in countries that participate in your program?

And if I may include one other item, I am deeply concerned about the lack of emphasis on women's participation. These countries, historically, are notoriously failing to take advantage of the enormous potential of women to contribute to economic development. Concept papers and proposals for MCA-eligible countries, as well as the Madagascar Compact, in my judgment, do not adequately address how women will participate in, contribute to, and benefit from your programs.

Mr. APPLGARTH. Let me address each of your questions in order, Mr. Lantos.

First, in terms of the timing of the appointments of the two remaining members, the latest information I have is that they have cleared initial vetting in the White House and that they are in the stages of getting ready for an intent to nominate. That is the best that I can tell you at this point.

In terms of the audit committee, I also believe we should have an audit committee. We need the additional members to really staff it appropriately. Both the Chair of the board and I cannot really participate on the audit committee, and we need the additional members to fully staff our board committees, and it is my hope that as soon as we have the board, we can constitute it. We think it is quite important. We take the outside audit function quite seriously.

In terms of civil society involvement, first, we do take this issue very seriously. We take the consultative process very seriously. As you know, that is one of our two key tests of a compact proposal. First, will it lead to poverty reduction and growth? Secondly, was the process adequately consulted [sic]?

We have quite different feedback on the Madagascar and Honduras consultative processes than what you reported. I will be happy to hear more directly from your staff what they found. We do address it quite seriously. One example: Ken Hackett, who is the head of Catholic Relief Services, who is on our board, has provided us field reports from Catholic Relief Services from each of the countries, and we have tried to address each of those concerns. And, I think, if you look at the consultative process in various

countries, you will see, in some cases, where there was a slow start but significant improvement over time.

In Madagascar, for example, and I think my written testimony reflects this, the government organized six regional workshops. Each consisted of 50 to 150 representatives of the business community, non-governmental organizations, civil society, and donors in all provincial capitals. The government also ran radio and TV broadcasts about the MCC, and published newspaper ads that announced meetings and called for submissions of proposals for many areas.

I think several independent observers, because we do spend a lot of time in due diligence, think the Madagascar Compact was broadly consulted, and I do not know who the staff talked to, in particular. We would be glad to understand it better because this is important to us.

In Honduras, I think there has been significant improvement, and the process is still ongoing, particularly as the projects are designed at the local levels. We also were concerned initially about what we saw as the initial amounts of consultation in Honduras, but we have seen significant improvements over time, and I would be glad to discuss it further with you, going forward.

In terms of the relationship with USAID, I think it is working quite well. Administrator Natsios is on the board. In addition, I see him frequently. We met regularly to talk about specific issues. USAID is working with us to implement the Threshold Program, and, in addition, in the field, we get a lot of support and assistance from USAID mission heads and USAID staff, and I do not think we could accomplish our mission if the relationship was not as good and positive as it is.

Lastly, your question on the lack of emphasis on women. We also believe women play a very important role in the development process and, as you know, Congressman, actually changed one of our indicators this year, which was focused on primary school completion rates, to focus on girls' primary completion rates. We found a better link to poverty reduction and to growth by focusing on that indicator and trying to emphasize that policy.

I think, if you look at the consultative processes in countries, we look at participation of women's groups in the consultative process and, of course, are looking, when we look at beneficiaries, as required by our legislation, at the impact on women and girls. We would do it anyway and do it. In fact, we have on-line, baseline data gathering going on right now in Madagascar and some in Nicaragua so we can establish the appropriate baselines to measure the impact of the programs on women and on other targeted groups.

Mr. LANTOS. Thank you, Mr. Chairman.

Chairman HYDE. Mr. Rohrabacher?

Mr. ROHRABACHER. Thank you very much, Mr. Chairman. And I appreciated your description of how you are totally different in your focus from USAID and other such efforts that are being made by our Government to help people in catastrophic situations and trying to help people build a better life for themselves overseas.

Unless I am wrong, really, a very important element of what you are doing, as I mentioned, is looking at the policies of a government

that would be contrary to what is necessary for that country to expand and to grow and to make sure that their economy was able to function in a way that people would be uplifting themselves.

There are many such factors involved: High levels of taxation, for example; confiscatory taxation. You cannot have an economy prospering with things such as that. If you could tell me a few of those areas that you would look at such as that, but one thing that I am particularly concerned about deals with its treatment, and the honest treatment, of property within their society.

The last time you were here, I brought to your attention the plight of a family living in my district, the Brahami family, immigrants from Ethiopia who are now United States citizens, and they have been victimized by the Government of Ethiopia. Specifically, the current Government of Ethiopia has failed to return property that was illegally confiscated from the Brahami family by its former Marxist regime. They will not give the property back, but they also will not give just compensation for it.

Now, OPIC, which is an agency of this government, has made a determination that the Brahami family has a legitimate claim. So the reason I am bringing this up again today, as I had mentioned that to your before, I would like to ask you to confirm whether or not this type of confiscatory policy by a government like that of Ethiopia, if the countries you are dealing with, they have that type of policy, are they eligible for your assistance?

Mr. APPLGARTH. Thank you, Congressman. In the case of Ethiopia, they are not eligible because we do look at exactly the kinds of things that you are talking about. Rule of law, corruption, and good governance are key indicators for us to look at in determining whether there is a proper environment in the country that will really mean our money is used well.

Mr. ROHRABACHER. When you say "rule of law," that it would include the rule of law of how confiscated property is dealt with.

Mr. APPLGARTH. It would include the whole effectiveness of the court system, if it was an appropriate administrative area. It shows up in several indicators. It shows up in corruption. It shows up in the rule-of-law indicators. It shows up in the government-effectiveness indicator.

Mr. ROHRABACHER. For example, in this case, their particular case was taken out of the official structure that had been set up to deal with confiscated property and put in someone else's discretion, which indicated that there might be some corruption involved.

So the rule of law would include how confiscated property—

Mr. APPLGARTH. It would include those kinds of things, yes, sir. If a government is not committed and has already demonstrated its commitment, not promised, but demonstrated its commitment, to anticorruption, rule of law, protection of property rights, and opening up the country in terms of economic freedom, investing resources in health and education, then they are not going to qualify. That is what the competition is all about. That is, at the end of the day, what we are trying to incentivize through the MCC, and we are seeing that impact.

I did, in my oral testimony, make some remarks, but you saw it even when President Yuschenko was here from Ukraine. He talked about Millennium Challenge in his remarks before you. And we

have had separate meetings with the new Government of the Ukraine, talking about the criteria, what they would have to do, take steps to qualify. Right now, they do not qualify under our indicators. They are looking at things that they would have to do.

I will give you another example. I spent an hour yesterday with the finance minister of Nigeria, going through their ranking sheets and their ranking, indicator by indicator—what was involved, who did it, and what was being measured—because they are not eligible, nor as a threshold country, but would like to be at some point and are beginning to focus on the kinds of policy reforms, what is needed to change to really promote poverty reduction. It is these kinds of leaders, these kinds of reformers, that we are ultimately arming to make the changes in their countries.

Mr. ROHRBACHER. Well, do not lower your standards. Thank you very much. We are going to be watching and wishing you well. Thank you very much.

Mr. APPLGARTH. Thank you very much.

Chairman HYDE. Mrs. McCollum?

Ms. MCCOLLUM. Thank you. I have a question—discussions with Armenia, and I will just take that at some point—

Mr. APPLGARTH. I would be happy to brief you in detail on Armenia.

Ms. MCCOLLUM [continuing]. Status with the Armenian dialogue.

My questions have to do with some of the discussion that was brought forward by Mr. Lantos about involving NGOs, not just U.S. NGOs, but NGOs in-country in general. There are many references in the GAO report and discussions with World Bank and other groups, but there seems to be some confusion among country officials knowing what their full range of potential could be; in other words, what they might be looking at for dollars so that they can actually kind of plan accordingly, and this is in the GAO report on page 18.

Honduras, and I will use that as an example because that is in the GAO report, talks about how local farmers were not brought into the discussion as much as they could have been, rural farmers, discussion of where the roads go. I come from an egg State, and even though I am in St. Paul, believe me, I know how important farm-to-market roads are, and you have got to be talking to the right farmers so that they can come together in cooperation to get the biggest bang for our buck in putting in the roads, but also that the roads make sense for them. Some of the points that are made in the GAO report is that we could have done much better outreach in talking with local farmers.

The other criterion I would like you to discuss has to do with environmental issues. For example, if we are not talking to all of the farmers about environmental integrity when moving forward on projects, it is a true missed opportunity. There seem to be different criteria that are applied when it comes to environmental health and safety hazards—that is pointed out in the GAO report—and so environmental assessments currently are held out in some kind of interim guidelines.

When you were before the Committee before, I asked, in the Millennium Challenge Account, would you be using USAID environmental guidelines, at least until you came up with your own. I had



an amendment to put it into place. It was with best intentions that the amendment not be offered at this point in time because you were working on something. Everything still appears to be interim, and I would like to know where you are, at least as a stopgap measure using USAID environmental standards.

Another barrier, and I will go back to the fact that we are working with the poorest of poor countries, is we are asking the host country to be responsible for conducting the environmental review and assessment before the compact is signed, or could there possibly be an agreement that you would take into account even before any assessments are completed? So I would like to know where we are using consistency with environmental standards, and I will use an example of a project that is not a Millennium Challenge project that took place in a Latin American country.

Beef cattle was very much wanting to move forward in this country, and they decided that they would go forward and clear land and move with beef production. The outcome of not having done a clear environmental assessment was the rapid spread of malaria in that area because there was no environmental assessment to look into to see what was happening. Now, we just spent many hours yesterday talking about malaria and the seriousness and what we need to do as a country in working with other nations to eradicate or, at a minimum, prevent the spread of malaria. So if you would address that, I would appreciate it.

Mr. APPLGARTH. I will try to, Congresswoman, and I hope everybody was able to hear you.

First, on the consultative process, I talked some about that, how important it is. Obviously, it is going to differ country by country, culture, and so on, but there are certain minimum standards that we would like to look for, and we have, based on the early compacts that we have seen and the early progress we have made, we have recently actually put on the Web some guidelines for a consultative process. None is a requirement that a country must do this or that, but there are out there examples for how it has worked in countries where we are seeing a good process to allow countries to take a look at them because they are looking for examples.

This is a new process for the countries, this idea of country ownership where they are actually taking responsibility for their own destiny, choosing their own priorities. They are working it through. We are helping them work it through, but we had a lessons-learned seminar of all of the eligible countries here 2 weeks ago with the World Bank during the World Bank/IMF meetings. All of the senior ministers were in town. They sat around—it was a workshop for them—each of them was talking about issues they were facing in the countries and exchanging ideas of how they were solving it with their own countries. I think that is an example where you are seeing the country ownership taking effect here. I think you see it in the consultative process.

We view the consultative as very important. It has to meet several standards. One, it needs to be timely. It has to be in early enough in the process so that the participants have a chance to really influence what is going on.

Second, it has got to be participatory. So we want to see a lot of different groups. We want to see local NGOs involved. We want

to see farmers' associations. We want to see women's groups. We want to see the business community. We believe—in, at least, the earlier ones—we are seeing that kind of involvement. And we want it to be meaningful, not just for show. We want to see some impact of the consultative process on the proposal.

Actually, you mentioned Armenia earlier, and I think that is a case where you are seeing an impact. What it will look like at the end is going to vary. My personal standard for a good consultative process, when it comes to one of our countries, was where I was actually meeting with a leader of the opposition, and we concluded the meeting, came out, and there were some people from the press there. They asked him about where he thought the consultative process was going. He says, "I do not agree with everything that is in the proposal. The proposal is not going to be a consensus. We understand that, but I will give the government credit for having a genuine, open consultative process."

Now, to get the leader of the opposition to say that, I think it is a pretty good standard. I do not think we are going to achieve that everywhere, but we do take it seriously, and I think you are seeing it in many of our countries. Those that are going slower; they are learning.

In the case of Honduras, the proposal itself, actually, is on the Web, if you want to see the detailed proposal. It is focused on integrated rural development. It does involve a lot of farm-to-market roads that are targeted to improving rural incomes, agricultural incomes. I think a lot of it has come out that reflects an environmental process at a sort of macro level. The detailed planning at individual project target areas is still ongoing, and that consultative process needs to be continuing, and I believe it is continuing.

Lastly, on the environment, we really tackle it in two things. One, the last time I was here, I mentioned that we did not have an environmental indicator. Since then, we have established a group headed by Christine Todd Whitman, who is on the board, to focus on seeing whether we can get a good indicator that applies across many countries for management of natural resources. We have brought together some of the best environmental economists in the country to help on this. I think there has been a lot of active participation. I would be happy to give you a separate briefing on this, if you would like; it is so important.

And we have published draft guidelines now for how we are going to evaluate compact proposals. We have put it out for public comment. Those comments are due back June 1st, and, I think, once we have that input, we will be able to publish our final guidelines.

Chairman HYDE. Ms. Barbara Lee?

Ms. LEE. Thank you very much, Mr. Chairman. I want to thank you for holding this hearing because the jury for me, of course, is still out on MCA. And I appreciate Mr. Applegarth being here and answering the questions, and, I guess, I need to first ask a couple of questions because I have got to make sure that what we authorized is still what is actually the law, and it is my understanding now that some of what this Committee authorized, the appropriators took out, one of which is an amendment that I offered.

And I would just like to ask you, given that you are really not required to do this, as this Committee wanted you to initially, I want to get a handle on the efforts with regard to the purchase of goods and services. And while I understand that MCA, primarily the money has got to get out to the countries, I do know that when we talked about this, that you will be utilizing the services and goods of American companies to perform certain activities. And my concern, and what I wanted to do, and what this Committee did, was ensure that minority women-owned businesses and small businesses participated in that activity.

So could you tell me kind of what you are doing in terms of the types of goods and services from U.S. companies that you are buying and then, what has been your involvement with small, minority- and women-owned businesses? Because we actually had authorized a report to come back to this Committee after a year giving us that information, but since the appropriators, I guess, took that out, we have no way of knowing. So that is my first question.

Mr. APPLGARTH. Thank you, Congresswoman. I apologize. As you know, a lot of people date MCA from the announcement at Monterrey 3 years ago. The first 2 years were really getting the legislation developed and the discussions on the Hill, and I was not around for much of those discussions. I cannot track what happened to every amendment, but I will certainly try to find out for you. You, obviously, know it better than I do.

But in terms of the U.S., procurement that we do—

Ms. LEE. Right.

Mr. APPLGARTH [continuing]. We follow all U.S. Government-procurement rules, and I think, maybe even more than follow the rules, we follow the spirit of the rules. First and foremost, even if we did not have a rule of really insisting on open competition, multiple bids, we would do it anyway. I have done it throughout my career. I think if you tracked—at various organizations, we bid out virtually everything. Okay? And so that fundamental standard is there.

In addition, we want to create an open playing field for everybody, and I have just been handed a note that says the majority of our contracts are actually with women and minority businesses right now. I would like to provide you some more information on that.

Ms. LEE. I would like to get some information because I want to see how you are utilizing the 8[a] program and also the types of women-owned businesses and minority-owned businesses that you are utilizing and how much you are buying and what you are buying and what percentage—

Mr. APPLGARTH. And we would be glad to provide that. I think we are seeing that a number of the 8[a]-type companies can service us here in Rosslyn. I think when you start talking about providing services in a variety of the places that we are working, they really do not have the representation there, and I do not even know how many bids we are getting, frankly, but we can certainly find out.

Ms. LEE. Okay. So you will get us the information.

Mr. APPLGARTH. And then I think you see what is happening in the countries. We try to ensure that procurement happening in

the countries is, of course, fundamentally by the countries themselves, but we want to ensure it is an open playing field, that people have a chance to participate, including locals.

Ms. LEE. Sure.

Mr. APPLGARTH. We want everybody to have a chance because this building of local capacity is part of our mission, and that is what we want to see happen, and I think we try to do it through a variety of things in the fiscal-accountability area.

Ms. LEE. Sure. I understand that, and I am glad that is the main goal and the mission, but I also know, as with USAID, that, in many ways, we want local companies and organizations to provide the goods and services or deliver whatever product or service USAID is doing. But minority firms in America have a very difficult time when, in fact, USAID has contracts available, to penetrate USAID, and so I am concerned that MCA could be another entity that has those barriers which preclude minority- and woman-owned firms from—

Mr. APPLGARTH. Well, I would share that concern. I do not think we have those barriers, but if you identify them, we will be glad to look at them.

Ms. LEE. Okay. So you are going to get us the information.

Mr. APPLGARTH [continuing]. Is there to make sure that we have the opportunity for people.

Ms. LEE. Thank you very much.

Chairman HYDE. Ms. Watson?

Ms. WATSON. Thank you very much, Mr. Chairman, and thank you very much, Mr. Applegarth. You have an awesome task, and I have worked with USAID in several of the countries, particularly in Africa, with programs of AIDS.

A couple of things. Most often, monies that come in through you, a great portion is eaten up in overhead. You might want to comment on that.

And then, second, I, too, am extending the question, I guess, that Ms. Lee raised. I really want to know how you work with the civil society because it has been the experience that corporations that contribute and have projects will make promises, particularly where there are environmental concerns, and then they make the promises to the government, but the people in these communities where these projects work do not get a chance to have their input periodically. So I have suggested—we were in Chad just recently—that they hold periodic forums so that the community in which these programs exists will have input all along the implementation of these programs. Can you comment, please, on those two areas?

Mr. APPLGARTH. Certainly. We are still developing formal benchmarks on the administrative-expense standard. I think, though, if you look at our administrative budget versus funds under management, the ones we are trying to do, you would be very pleased. I think, by any standard so far that we have been able to identify, we are significantly below the overhead ratios and the cost ratios of other organizations, both private sector and public sector.

In terms of working with civil society, I mentioned earlier, the consultative process is very important to us. I think, in every country that I have visited, and I have visited almost all of our eligible

countries and some more than once, I have met during my visit with local representatives of civil society and encouraged them to both participate in the consultative process and in the monetary-implementation process, bidding, if appropriate, on some parts of program implementation; bidding and participating in monetary evaluation, and also whether or not they are formally involved, to get involved in monitoring the overall progress.

Every compact we sign is going to be on the Internet. It is going to be available in the country to the beneficiaries of the compact so that they can see firsthand where their money is supposed to be going and who is supposed to be benefiting, and we look to them to be part of the front line in alerting us if it is not getting there. Now, we have a lot of other checks and balances, but that is there.

In addition, what a number of our countries have actually implemented is your suggestion about a forum. I think, if you look in Georgia, if you look in Armenia, if you look in Madagascar, they have town meetings around the country, i.e., what should be the MCC priorities, what should be in the proposal, and what is the reaction to whatever the government has suggested? So I think you are beginning to see that in some of these countries, many of whom do not have this kind of a history of law.

Ms. WATSON. Let me just add that it appears in some of the countries that the government overwhelms the civil society of the people, and statements on the environmental issues there are conflicts between the government's position and the people's position. And I recall Nigeria, several years ago, when Shell Oil Company came in, and they were pumping oil down in the Goni Delta region, and Sierra Wewah was the one that was complaining, and they ended up in a scuffle, and people died, and four of them were hung. That has always stayed in my mind, and so as I have traveled throughout Africa, we have always looked at whether or not the locals have had a voice that was meaningful.

So are we still in 14 countries with USAID?

Mr. APPLGARTH. I am sorry. What was the last—

Ms. WATSON. Are we still in 14 countries that are eligible for USAID?

Mr. APPLGARTH. Well, within MCC, we have 17 eligible countries right now.

Ms. WATSON. 17.

Mr. APPLGARTH. 17.

Ms. WATSON. Okay.

Mr. APPLGARTH. Sorry. Go ahead.

Ms. WATSON. I just wanted to say, I always look for guarantees that those lone voices out there do not get outshouted by what the government wants because it is those people who these projects that we get involved in are supposed to benefit, and often it goes in a different direction.

So I just want some assurance from you that the Millennium funds and the contracting and so on will have a greater benefit to the people within the region and the area and not necessarily to the overall Federal Government, but it is the people whose areas they are in. And I just wanted to hear from you what kind of protections we build into these contracts and what kind of oversight, and is there a long-term follow-up?

Mr. APPLGARTH. I think there are several protections, Congresswoman, and the first is even in the selection of the countries themselves. We do not have yet a good indicator that we can publish in terms of management of natural resources, but, fundamentally, we are trying to assess countries and their commitment to it, and we are only picking countries that have demonstrated some commitment to it, so you start with that.

Secondly, in the consultative process, which we take very seriously, we want the local people to be involved, and I will give you an example in a minute where I saw where the government was giving us the wrong information. Country ownership means that the country determines the priorities, but we do not want people in Washington or Bonn or Paris setting the priorities for the country. We also do not want a couple of people in the ministry of finance in the country setting the priorities. We want a broad-based, consultative process. If it is being done right, those kinds of environmental concerns and other kinds of concerns are popping up in that consultative process.

But our third check is, we do not limit it to that because, in our assessment of individual projects, we also do an environmental review. The draft guidelines, as I mentioned to Congresswoman McCollum, are on the Web. We are now in the process where two projects have already started environmental impact assessments for the proposals even before approval because we want to make sure that it is not going to have a hazardous effect or a bad effect on the environment.

Coming back, on the consultative-process example, there was a country recently that had a long history of growing rice, and every government official told me, "Our people will only want to grow rice, and we do not want to focus on a program that will diversify crops because our people will not do it; it is in the culture." The people in the capital said that. We went out and talked to some agricultural extension workers in the field, in the patties.

So then I met with a group of farmers, and I sort of asked them the same question. I came at it a little bit differently. I said, "What would you like your kids to do when they grow up? Do you want them to be rice farmers?" They said, "We want them to be anything but rice farmers. We want them to go to the capital. This is not a future. We are barely getting by. We cannot get a good price for our crops. Everybody sells rice. This is not a future we want for our kids." To which I said, "Well, why do you not do other crops? Would you be interested in other crops?" "Yes." "Why do you not do them?" "Well, we do not know how to do them. Nobody has trained us."

So a big discussion then between the local agricultural extension workers representing the government and the farmers, and the farmers said, "Why do you not teach us about these other crops?" And the agricultural extension workers said two things they thought were key. Okay? One was, "We do not know about the other crops ourselves. We have not been trained, and the only thing we have been trained to do is rice, and, more importantly, that is what the government tells us our jobs are, to teach you how to grow more rice and better rice."

And if you listened simply to the government feedback, all the way up the line, even from the field, you would have gotten one answer that was very different than when you go out and actually talk to the people in the paddies, in the fields, elsewhere, about what they want and what their needs are.

I will never forget the last question I got there, which was, "Why is it that somebody from the United States or Washington is asking us more informed questions and asking things that are more relevant in our lives than anybody here from the government has ever asked us?" That is the challenge we left for that government when I was leaving.

Chairman HYDE. The gentlelady's time has expired. Mr. Boozman has waived his right to question, for which I thank him.

We have a second panel, so we are ready to give you some freedom, Mr. Applegarth, and we thank you for a very instructive testimony.

This panel, we are terminated with, and the second panel will please come forward. I want to welcome the witnesses on the second panel.

Dr. Steven Radelet is a Senior Fellow at the Center for Global Development, where he specializes in foreign aid, debt, economic growth, and poverty reduction in developing regions. He is widely recognized for his book, *Challenging Foreign Aid: A Policymaker's Guide to the Millennium Challenge Account*. Before his current position, he served as Deputy Assistant Secretary of Treasury for Africa, the Middle East, and Asia. He has been a Fellow and a lecturer at Harvard, as well as an adviser to the finance ministries of Indonesia and The Gambia.

Dr. David Gootnick is Director of International Affairs and Trade at the Government Accountability Office (GAO), where he has been since 2001. In his position, he oversees analysis of U.S. humanitarian aid, development assistance, economic assistance, and global health. Under his direction, a new GAO report has been released that examines the Millennium Challenge Account which Mr. Gootnick will discuss today.

Mr. Conor Walsh is the Country Director in Honduras for Catholic Relief Services. Honduras is likely next in line to complete MCA compact negotiations, and Mr. Walsh has followed MCA developments closely in Latin America. He also has extensive humanitarian and development experience in Haiti, Angola, and South Africa. We look forward to hearing his on-the-ground perspective of how the Millennium Challenge Account is playing out in Honduras.

It is a pleasure to have you all here today at this hearing, and we look forward to your insights as we examine MCA. We ask that you proceed in the order in which you were introduced, providing a 5-minute summary of your written statements. Your complete statements will be made a part of the record. We expect votes at about 1 o'clock or 1:15, so let us see if we can get your testimony in before we have to adjourn. Mr. Radelet.

**STATEMENT OF MR. STEVEN RADELET, SENIOR FELLOW,  
CENTER FOR GLOBAL DEVELOPMENT**

Mr. RADELET. Thank you very much, Chairman Hyde, and thanks for the opportunity to appear before the Committee today.

Two years ago, I testified before this Committee that the Millennium Challenge Account had the potential to significantly improve the quality and effectiveness of U.S. foreign assistance. I think that that potential remains today and that the MCA remains very promising as a vehicle for the people of the United States to achieve some of our most important foreign policy goals: Encouraging freedom, economic opportunity, and good governance; demonstrating American values to the world; and fighting poverty.

The promise of the Millennium Challenge Account to be innovative and effective is based on several key principles that you are aware of. One is to focus on growth and poverty reduction. The second is to select countries that are the most committed to sound development policies, to allow local leaders to set their own priorities, to provide enough funding to make a real difference on the ground, and to hold the recipients accountable for results.

The MCC has made substantial progress to date since its founding just over a year ago, and Mr. Applegarth has already discussed that, and there is no reason for me to repeat it. But I do believe that over the last year, since their founding from absolutely nothing, that they have made some significant progress.

However, despite these steps forward, I believe that the MCC faces some key challenges going forward. Its progress to date is less than many of us had hoped and expected, and I believe that this next year will be very critical for the organization to scale up its vision, to increase its speed, and to ensure high-quality programs to support growth and poverty reduction in some of the poorest countries in the world.

Mr. Chairman, you mentioned several important concerns, and I concur with many of them. I want to mention six specific challenges going forward. Number one is to scale up the original vision of the MCA. Achieving this bold vision laid out by the President requires providing enough funding to make a real difference and to create the incentives for reform on the ground.

The original vision called for \$5 billion in funding per year, implying compacts the size of \$150–250 million per year and to be the largest donor in many of the recipient countries. However, the compacts that we are seeing so far, both the one that has been signed and the ones in the pipeline, are much smaller than that. The Madagascar Compact is about one-sixth of that size, and the ones in the pipeline might be about one-third that size, on average.

The MCC, at the moment, is on track to become the third- or fourth-largest donor in most recipient countries, not the largest, and I think this undermines its ability to make a big, bold difference and to create incentives for important change. The MCC must encourage countries to be bigger, bolder, more innovative, and not small and average. It should not encourage countries to cut back to be safe or because it does not have adequate staff. Of course, it should not be reckless, but it should encourage countries to be bold enough to make a real difference on the ground.

The second concern is balancing the tension between the consultative process quality and speed. There has been a lot of concern about speed. I do not think that the time taken to get to the first compact of 11 months is a problem. I actually think that that is quite appropriate and necessary to have the appropriate kind of



consultative process. My concern is not that it took 11 months for Madagascar; my concern is that, at this point, we have only got Madagascar and only four others in the pipeline. We seem to not be close to decisions on the other 11 countries that were selected 1 year ago.

Some of this is startup and growing pains, but we should be much closer to decisions on these other countries. One possibility would be for the corporation to set itself some firm deadlines and stick to them. I would recommend that the board set up two deadlines per year when they will make firm decisions up or down on proposals that have been submitted to them.

For example, they could have a board meeting in May and another in September and tell the countries that they have a deadline 1 month before those meetings to submit proposals. If they do not submit proposals on time, they can submit them for the next board meeting, but the board would evaluate the proposals in front of them and vote up or down so that we could have some certainty. These kinds of deadlines, I think, focus attention and would be good for both the recipient and the corporation.

Third, I think it is very important to firmly establish the principle of local ownership. There has been much discussion already this morning about the importance of local ownership, and, indeed, that is one of the innovations of this program. Both the Administration and Congress, and especially the authorizing committees, deserve enormous credit for this intervention and for refraining from placing too many directors on the program and allowing local leadership to come to the fore in setting priorities. This is really important, I believe, to enhance local ownership, to ensure stronger commitment on the ground, to meet the highest priorities, and to increase the effectiveness of every dollar that is spent.

But maintaining this local ownership will be a real challenge. Lots of observers on the ground and here, in Washington, want to put their own priorities forward. We cannot, on the one hand, extol the virtues of local leadership and, on the other hand, try to influence and second-guess program content. Undue micromanagement will weaken programs. Good poverty-reduction and growth programs require a combination of investments in health and education, good governance, and a robust private sector. The MCC need not fund all of those aspects, but it should be funding parts of it in a broader growth and poverty-reduction program.

But there is concern that the MCC is not allowing for this full process and may be imposing some of its own priorities. I think the corporation needs to be much clearer on its expectations on the consultative process and transparently describe the process that it is using to judge programs.

Fourth, the corporation needs to ensure higher-quality programs, and I think there are two ways to do this. First, I believe that it should engage an independent, technical review panel to evaluate every proposal that it receives, with outside experts that are experts in the field, that have much more expertise than the MCC can have in-house, to provide recommendations to the board on every single proposal.

Second, it must have a much larger staff size, as was mentioned earlier. With 200 people, a corporation financing \$2 billion a year

or more would make it, by far, one of the smallest staffings for financial organizations of any organization in the world, and I fear that this staff size is way too small. The International Finance Corporation, for example, distributes about \$3 billion a year. They have a staff of over 2,000 people. Being lean is admirable, but if we are too small, we will undermine efficiency.

The fifth concern is that we need to demand results while encouraging innovation, and I am particularly concerned about having high-quality monitoring and evaluation for these programs to create good incentives that will reward results, to make sure that we allocate resources to the most effective programs, to keep programs on track and get early warning when they get off track, and to learn from our experience.

Monitoring and evaluation is very complex, but, unfortunately, the corporation is allocating only 16 staff members to this important task, and I believe there is a real risk that they will make the same mistake that so many other aid agencies have made, to underfund and undervalue evaluation.

Finally, we need to target the right countries, and here there are two issues. There has been so much talk about the country-selection process; I think, too much. There are a lot of issues that could be improved. It must be strengthened, but it is easy to nitpick and miss the fact that what we are trying to do is, objectively and in a nonpolitical way, choose the best kinds of countries, and I think they have done an admirable job so far, although it can be strengthened.

The second issue where I have more concern is the introduction of lower middle incomes this year to expand the program to a new set of countries with higher income. These countries, in my view, have less need. They have higher savings rates, higher tax revenue, and much higher private capital flows, and most of them are graduating from foreign aid. To expand the program this year, I think, creates a danger of allocating some of our scarce resources to these richer countries instead of those with greater needs.

Given the MCC's relatively slow start and the fact that it is not close to achieving the envisioned \$5 billion in funding, I think that we need to concentrate our efforts this year on the countries that have been selected before expanding to a larger group. At a time when the organization is more mature and funding more secure, we can think about perhaps bringing in these lower-middle-income countries. At most, the corporation should choose one or two, if any, to receive funding in Fiscal Year 2006.

Mr. Chairman, the MCA, I believe, still has great promise for the American people to deliver aid more effectively, and I believe it deserves our full support in this startup phase, but the MCC must step up this year to fully meet its vision by scaling up its programs, increasing its speed, and funding higher-quality programs. Thank you very much.

[The prepared statement of Mr. Radelet follows:]

PREPARED STATEMENT OF MR. STEVEN RADELET, SENIOR FELLOW, CENTER FOR  
GLOBAL DEVELOPMENT

Two years ago before this committee, I testified that the MCA had the potential to significantly improve the quality and effectiveness of US foreign aid. The original concept of the MCA—identify countries with a strong commitment to development,

provide them with substantial funding for high priority activities to support economic growth and fight poverty, limit bureaucratic interference, and hold recipients accountable for results—remains very promising as an innovative vehicle for the people of the United States to achieve some of our most important foreign policy goals. It provides the United States the opportunity to use our strength, stature and resources to show the world that we can lead the way in helping low-income countries provide economic opportunities, stimulate economic growth, and fight poverty.

The MCC has made important progress in several areas towards achieving that vision. It has established a lean organization that is taking seriously the ideas of country ownership and consultations in program design. It identified a reasonably strong set of countries to submit proposals for funding. And it is considering a wide range of substantive proposals to support poverty reduction and growth. In other areas, however, progress has been slow and is falling short of the original vision, particularly in terms of size and speed.

This next year is critical for the MCC, as the time has now come to take the bold steps necessary to turn its great potential into reality. The MCC faces six key challenges:

1. Scaling Up to the Original MCA Vision
2. Balancing the Tensions Between the Consultative Process, Quality and Speed
3. Firmly Establishing the Principle of Local Ownership
4. Ensuring High Quality Programs
5. Demanding Results while Encouraging Innovation
6. Targeting the Right Countries

The MCC must now move from its initial start-up phase to become a mature, strong, and professional organization that puts the United States at the forefront of innovative and effective development assistance. I believe that as the MCC takes the steps necessary to achieve that vision, it deserves our continued strong support.

#### THE MCA'S PROMISE AND POTENTIAL

The MCA builds on America's core values of generosity, commitment to progress and poverty reduction, and the expectation of clear results. It operates on six key guiding principles that set it apart from most other foreign aid programs:

- It focuses clearly on promoting economic growth and poverty reduction, rather than supporting diplomatic and political partners or achieving other goals, which can be supported with other programs. The sharper focus and clearer goals should help ensure that both recipient countries and the American public get better outcomes.
- It selects a small number of recipient countries that have demonstrated a strong commitment to sound development policies, helping make aid funds more effective.
- It allows recipient countries to set priorities and design programs, engendering stronger commitment for success by recipients, and ensuring that programs actually are aimed at meeting the most urgent local needs.
- It keeps its bureaucracy to a minimum, avoiding the large administrative structure and heavy regulation that bedevils some other aid programs.
- It is designed to provide recipients with sums of money large enough to make a real difference on the ground and provide strong incentives for success.
- In principle, it holds recipients much more accountable for achieving results, including being willing to increase funding for successful programs and reduce it for weaker programs.

#### IMPORTANT PROGRESS TO DATE

During its first year, the MCC has made important progress in several areas:

- *Establishing the organization.* The MCC has established itself from scratch in just over one year, working rapidly to hire key staff, open offices, and set up the basic functions of the Corporation. It moved as quickly as the legislation allowed to convene its Board of Directors, announce country selection methodology, and select MCA and Threshold countries for 2004 and 2005. Despite being short-staffed in the early period, it made efforts to visit eligible countries to inform them about the MCA and worked with USAID to establish the Threshold Program. It has now received proposals from 16 of 17 MCA-eligible countries and from all countries eligible for the Threshold Program.

- *Creating incentives for policy reform.* The MCA has garnered significant attention abroad, with many low-income countries expressing interest in participating in the program. According to the MCA, the incentives for policy reform are already at work. For example the median number of days to start a business fell from 63 in 2004 to 45 in 2005, in part due to the emphasis the MCC placed on this indicator. Moreover, the MCC sites several countries that have passed tough anti-corruption legislation in hopes of being considered for the MCA. These results must be interpreted with caution, however, because the median score for other indicators actually worsened from 2004 and 2005. For example, the medians for political rights and civil liberties both deteriorated from a score of 4 to 5—more likely attributable to the inclusion of a wider pool of countries in 2005 than any incentive created by the MCA.
- *Negotiating and signing the first compact.* The signing of the first country compact 6 months after the initial proposal was submitted is an important milestone. This pace was appropriate, as it takes time to work with countries to set their own priorities and map out a set of programs that complements a national development strategy.
- *Adhering to a vision.* To some degree, the MCA has adhered to its vision of being more focused and more nimble than traditional aid programs. An important part of this is that the Congress has given the MCA greater flexibility and fewer directives, which should help increase innovation and effectiveness. The MCA's success will rely partly on the freedom from pressure to contribute to strategic foreign policy goals beyond targeted poverty reduction and economic growth, and freedom from directives that obligate spending in certain sectors.
- *Promoting transparency.* The MCC is unique among US donor agencies in the amount of information easily available on its website. It is particularly notable that the MCC posts all of the data used to select eligible countries, opening itself to unusual scrutiny. The MCC has been partially successful in setting a standard for transparency among eligible countries as well. Of the 16 that have submitted compact proposals, half have made their proposals publicly available on national websites.
- *Engaging with the public.* The CEO and staff of the MCC have made themselves available to interested parties through outreach meetings, individual consultations, sessions with eligible-country embassies, and participation in NGO working group meetings. The MCC was receptive to suggestions that it change one of the selection criteria to include girls' primary school completion rates, and has opened for public participation the deliberation on an indicator for natural resource management.

#### KEY CONCERNS AND CHALLENGES

Despite this early progress, the MCC faces several key challenges going forward if it is to achieve its full promise and potential. In its first year, the program, understandably, has experienced some growing pains. The next year will be critical for the organization to scale up its vision, increase its speed, and ensure high quality programs to support growth and poverty reduction.

##### *Challenge #1: Scaling Up to the Original MCA Vision*

The MCA provides a bold vision for how the people of the United States can support committed and dynamic governments in fighting poverty, creating economic opportunities, increasing growth, and improving the standard of living for some of the world's poorest people. For the MCA to really help committed governments transform their economies, it must (1) provide substantial funding to make a real difference on the ground, (2) provide strong incentives for countries to take the steps necessary to become eligible and implement strong, successful programs, and (3) hold countries accountable for results.

The President's original proposal called for \$5 billion in funding each year, implying compacts that would be in the neighborhood of a minimum of \$150–\$200 million per year or more, making the MCC the largest donor in most countries. Countries would be willing to take the steps necessary to qualify, consult widely to design their own programs, and work hard to implement them successfully if they believed that substantial funding would be available with low bureaucratic costs, and that results would be rewarded. This would lay the foundation for the powerful combination of improved policies to become eligible, substantial funds to make a difference in people's lives, and the incentive to achieve results to enable continued funding.

At this early stage, however, it is not clear that the MCC is on track to achieve this vision. Its first compact in Madagascar calls for around \$27 million per year,

far smaller than the original vision, and just enough to make the MCC a slightly larger than average donor in the country. For the first 16 eligible countries, the MCC is currently reviewing proposals amounting to about \$3 billion over 3–5 years—an average of about \$40–60 million per country per year, depending on the length of the compact. This would make the MCC the third or fourth largest donor on average in the recipient countries. Programs of this size are only one-quarter to one-third of the original MCA vision, and as such are unlikely to be large enough to bring about significant change and create the incentives for improved performance. By contrast, aiming for compacts for 12 of the first 17 countries over four years of a size equal to the largest donor would require MCC commitments of about \$5.5 billion, a far better target.<sup>1</sup>

The Corporation must encourage countries to be big, bold, and innovative in their proposals, and not discourage them from large proposals, as sometimes has been the case. For example, reportedly Armenia's original proposal amounted to \$900 million, which has now been revised to \$175 million. Madagascar's final compact left out several components that were in its original submission, and Mozambique was also asked to scale back. Of course, the MCC should not just encourage a wish list with a hodge-podge of activities, but it should envision interconnected programs of a scale that can make a significant impact on poverty reduction and economic growth. MCA eligible countries have among the most committed and capable governments, and have shown their ability to use aid flows effectively. Each has huge needs for improved infrastructure, water supply, power, health, education, and other areas where funds can be well used. The MCC has the opportunity to work with governments to provide funding on a large enough scale, always holding them accountable for results (as discussed below), to make substantial progress in the fight against poverty. But aiming to be a slightly larger-than-average donor won't accomplish that goal.

*Challenge #2: Balancing the Tensions Between the Consultative Process, Quality and Speed*

Many observers have expressed concern that it took so long for the MCC to sign its first compact with Madagascar. Much of the responsibility for the slow start lies with the administration, rather than the MCC, which did very little preparatory work during the two years between the President's speech proposing the MCC and the passage of the enabling legislation. There was a missed opportunity to prepare guidelines for recipient countries, analyze options for financial flows, and consider various models for monitoring and evaluation. This, however, is now water under the bridge.

The MCC literally started from scratch just over a year ago, and chose the first group of eligible countries in May 2004 at the earliest possible date. In my view, given this start, it is perfectly appropriate that the first compact was signed in April 2005, 11 months after country selection. One of the strengths of the MCA is that it relies on country-led proposals, which require time to develop options, consult with stakeholders, and design high-quality interventions. There is an important balance to be struck between, on the one hand, the natural desire for speed, and on the other hand, the importance of a country-led process and the need to ensure quality. Moreover, there are certain growing pains inherent in a new organization that is hiring staff and establishing all new procedures while at the same time working with countries on proposals.

However, while the amount of time to get from country selection to the first compact was acceptable, the more relevant concern is that *only one* compact has reached that stage. Just four others are in advanced negotiation, and some of these may take several months to finalize. The other 11 countries in the first round are well behind schedule. Ideally, after one year, the MCC should be close to making decisions—either up or down—on all 16 of the first round countries, not just a few.

Currently the MCC works with countries after they submit their proposals in an attempt to strengthen programs. Since there are no deadlines, the process can continue for many months, sometimes with relatively little progress, without a clear decision on the proposal. An alternative that would help provide more certainty and speed the process would be to announce two Board dates each year during which decisions would be made on all submitted proposals. For example, the MCC could announce its country selections in October, and plan on Board meetings in early May and early September to decide on proposals. Deadlines for final proposal submission would be April 1 and July 15. This timing would provide countries more

<sup>1</sup> Actual disbursements from the largest donor in each of the 17 MCA eligible countries in 2003 totaled \$1.94 billion, or about \$114 million per country. 12 compacts of four year duration at this size would require commitments of \$5.5 billion.

than 5 months to prepare their proposal for the first round, and close to 9 months for the second round, which should be ample time to conduct consultations, prepare a proposal, and receive some initial feedback from the MCC. In its May meeting, the Board would make firm decisions to either approve or disapprove all proposals submitted by the April deadline. Disapproved proposals could be revised and resubmitted in time for the September Board meeting.

These kinds of deadlines, which are common practice among many foundations, would help focus the attention of both recipients and MCC staff, speed the process, and provide certainty to the status of all countries. The MCC currently use such deadlines for its Threshold Program, but not for MCA eligible countries. At a broader level, the MCC should set a range of goals and deadlines for itself—some of them public, as its recipients do—and measure its own progress against those targets

*Challenge #3: Firmly Establishing the Principle of Local Ownership*

The MCA's potential stems not only from its projected size, but because it promises to deliver aid differently and more effectively than many traditional aid programs. A key component is to give more responsibility and flexibility to recipient countries to establish priorities and design programs that can be tailored to local needs and circumstances. This is a very sensible approach, especially since MCA countries are chosen based on their demonstrated record of good governance and sound policy.

Both the administration and Congress, and especially the authorizing committees within Congress, deserve credit for this design. The administration refrained from placing too many directives on program content and formulation. Congressional authorizers wisely decided not to earmark funds for specific purposes, recognizing that local governments with proven records were better placed to determine the highest priorities. This process will greatly enhance local ownership, which in turn will increase commitment to success, improve program design, and increase effectiveness. As a result, each dollar of MCA funding is likely to have a larger impact on growth and poverty reduction.

Nevertheless, maintaining local ownership for priorities will be a challenge. Some observers believe, incorrectly, that for an MCC program to reduce poverty, it must always include investments in health and education. Others believe, equally incorrectly, that for a program to support growth, it must be aimed directly at finance and business. In fact, economic growth and poverty reduction are closely linked in most countries, with growth the strongest contributor to sustained poverty reduction. Sustained growth requires a combination of good governance, strong investments in health and education, and a robust private sector. In turn these three ingredients form the foundation of the most effective poverty reduction strategies. Of course the specific details and most appropriate combinations will vary across countries, which is why local ownership and direction is so important. The MCA need not fund all the ingredients of a strong growth and poverty reduction program, but rather should be aimed at filling gaps not met by local resources or other donors.

Supporters of the MCA cannot, on the one hand, call for stronger country ownership and, on the other hand, try to influence program content and effectively second-guess the priorities that eligible countries choose for their programs. Undue micro-management from afar will ultimately weaken the impact and effectiveness of MCA investments. At the same time, it is incumbent on the MCC to honor the country ownership process and not steer countries away from their stated priorities, as long as they are technically sound. This is particularly important in light of reports that the MCC has discouraged some countries from pursuing some stated priorities, especially in health and education, which can have a strong impact on both growth and poverty reduction. In the spirit of full transparency, the MCC must take steps to reassure Congress and the public that compacts actually represent country priorities. Towards this end, the MCC should publish guidelines for the consultative process, and more clearly and transparently describe the process it uses to judge the merits of initial proposals and the various components of proposals. As one part of this strategy, it should establish an independent technical review panel to help evaluate proposals, as described below.

*Challenge #4: Ensuring High Quality Programs*

*Technical Review.* The MCC is considering proposals covering a very wide range of substantive areas, including agricultural production, tourism, land titling, transportation, water, finance, energy, health, and education. The MCC's small staff does not have, and should not be expected to have, expertise in all of these areas. Yet it needs to make recommendations on the proposals, provide oversight, and conduct monitoring and evaluation. To ensure high technical quality, it will need to rely on

a combination of in-house expertise, staff from other executive branch agencies, and outside experts. The MCC is taking some steps in all three directions.

In addition, the MCC should consider establishing an independent Technical Review Panel of outside experts to evaluate all proposals prior to approval with respect to their technical merits and their potential contribution to poverty reduction and growth. The Panel would make non-binding recommendations to the Board. The panel should consist of non-partisan technical experts with deep knowledge of development that can provide expert opinion and commentary that will help strengthen proposals and assist the Board in distinguishing strong proposals from weak ones. The panel could combine a core set of members that would evaluate all proposals, together with additional specialists where necessary for certain proposals where the core panel may not have sufficient expertise.

*Staffing.* Both composition and size of the MCC staff are important. On composition, the MCC has placed a priority on hiring staff with fresh ideas from the private sector, complemented by professionals with government experience. This strategy has its strengths and to an extent should be encouraged, but it also has its limitations. In particular, while the current staff is a strong group of professionals with important skills, there appear to be relatively few with strong expertise in economic development, which could adversely affect program quality. While fresh outside perspectives are welcome, it is critically important to augment the current staff with experts in economic development and poverty reduction, along with experienced professionals with deep knowledge of the strengths and weaknesses of other donor approaches.

With respect to staff size, the MCC currently has about 120 staff members, and is planning to increase to 200 by the end of 2005. One of the key objectives of the MCC is to keep its bureaucracy and administration small, both to maximize the funds available to recipients and to ease the administrative burden on recipients. Aiming for a relatively small staff size is admirable. However, a staff of 200 is extremely small for an organization planning to disburse at least \$2 billion per year or more in the near future. At this size, the ratio of dollars disbursed per staff member is about \$10 million:1, a very high ratio. By comparison, the Ford Foundation disburses about \$1 billion with a staff of 600, a ratio of about \$1.6 million per staff member, the U.K.'s Department of International Development disburses about \$3.3 billion with a staff of 2,200 (\$1.5 million per staffer), and the International Finance Corporation disburses about \$3.1 billion with a staff of 2,200 (\$1.6 million per staffer). Very few organizations have a ratio as high as \$4 million:1, much less \$10 million:1.<sup>2</sup>

There is a real danger that the MCC's staff will be too small, which could significantly undermine efficiency and effectiveness in several ways. Too few staff would:

- Slow the speed of proposal review, negotiation, and disbursement. Whereas one compact has been signed and four are in negotiation, much less progress has been made on the other 12 countries, partly due to staff constraints in the first year.
- Impede communication with other agencies, Congress, and recipient governments. Communication has clearly suffered in the first year because of staff shortages. For example, whereas staff prepared guidance for recipient countries for writing proposals, it has not yet released guidance for the consultative process, financial responsibilities and mechanism, monitoring and evaluation, and other key processes.
- Overburden staff with responsibilities outside their expertise, leading to frustration and high rates of burn-out.

This is not a call for a large bureaucracy with unnecessary administrative staff, but a modest increase to ensure efficiency and effectiveness. A staff of approximately 300, rather than the envisaged 200, would be more in line with the envisaged size of the MCC's disbursements, and would bring the ratio of disbursements to staff size more in line with the most efficient foundations and financial organizations. It would strike an appropriate balance between the need for sufficient professional competence and a lean administrative structure, keeping the MCC amongst the smallest of donor agencies. In particular, the MCC should aim to recruit a larger number of staff with strong backgrounds and experience in economic development and more specialists in the critical roles of monitoring and evaluation, as discussed below.

<sup>2</sup> See Radelet (2003), *Challenging Foreign Aid: A Policymakers Guide to the Millennium Challenge Account*, page 114.

*Challenge #5: Demanding Results while Encouraging Innovation and Risks*

It is imperative that the MCC hold recipients accountable for achieving results. It should reward countries that achieve their targets with renewed funding, and reduce or eliminate funding for those that do not. A sound monitoring and evaluation (M&E) process is central to making the MCA highly effective in achieving results, in several ways:

- *Creating incentives.* Clearly rewarding success and penalizing failure will establish clear incentives for recipients to take all steps necessary to achieve specified goals. Without a strong M&E program, it will be impossible for the MCC to clearly distinguish successful programs.
- *Allocating resources.* A strong M&E program is essential to allocate more financial resources to successful programs, improving the impact of the program.
- *Keeping programs on track.* An effective M&E program can help detect problems at an early stage, and provide critical information to help countries get back on track. In this way, strong M&E programs help increase the probability of success by providing useful diagnostic information.
- *Learning what works and what does not.* A good M&E program will help distill the lessons from one program to improve the design of other programs. M&E programs help us learn what works, what doesn't work, and why.

Establishing a strong M&E program is complex. It requires skilled staff, adequate resources, the ability to acquire sound baseline data, and establishing appropriate, measurable goals. Unfortunately, most aid agencies substantially under-fund M&E, undermining the incentives for strong performance and limiting understanding about program effectiveness. It is too early to tell how successful the MCC will be in this regard, but one early sign raises a concern. Under current staffing plans the MCC is aiming for just 16 people in its M&E program, a woefully inadequate number. Staffing of this size threatens to repeat the mistake of other aid agencies that under-fund M&E. Far more skilled people will be needed in this critical area, supported by the financial resources needed to obtain the necessary data and carry out evaluations, if the MCC is to reach its promise of effective, results-based programs.

At the same time, sound judgment will be required to balance the need to penalize failure with the desire to encourage innovation and new ideas. Designing large scale, innovative programs will require time, patience, and some tolerance for risk. As with any investment banking or venture capital fund, not all MCC investments will pay large dividends, and we should all recognize up front that some will fail. But the risk of an occasional setback should not discourage the Corporation from aiming high, and should not detract from the potential for significant progress in many countries.

*Challenge #6: Targeting the Right Countries*

*The Country Selection Process.* More has been written and said about the MCA's country selection process than any other aspect of the program. In these discussions it is easy to get bogged down in the details, which are necessarily imperfect, and lose sight of the bigger picture and intended purpose. The selection methodology is designed to provide an objective, non-politicized process to distinguish countries that are committed to sound development policies that can use aid effectively from those countries that are not. As much as possible, the process relies on publicly available quantitative criteria rather than subjective back-room judgments. The problem, of course, is that no set of indicators can ever be perfect. The selection process for the MCC could be improved on the margin, but by-and-large it has succeeded in de-politicizing the allocation of aid funds and in providing a mechanism to hold accountable the MCC Board for its decisions. There are several ways in which the process could be strengthened, as I have described elsewhere.<sup>3</sup> But it should not be dramatically changed, nor should it be overloaded with many new indicators on topics unrelated to the MCC's core mission.

*Eligibility of Lower-Middle Income Countries.* Beginning in FY 2006, the MCC plans to add a second group of candidate countries consisting of all countries with per capita incomes between \$1,465 and \$3,035. The inclusion of these countries has always been controversial. They are much richer than the low income countries and have less need for foreign aid, since they have much larger private capital inflows, saving rates, and tax revenue. Generally, countries that reach this income level

<sup>3</sup>Radelet (2003) *Challenging Foreign Aid*, and Steven Radelet and Sarah Lucas "An MCA Scorecard: Who Qualified, Who Did Not, and the MCC Board's use of Discretion," May 2004, [www.cgdev.org/Publications/?PubID=118](http://www.cgdev.org/Publications/?PubID=118)



begin to “graduate” from aid and move to private sector finance. The counter-argument is that many of these countries have significant numbers of poor people that can effectively use MCC assistance. While this may be true, aid funds must be allocated to where they are most urgently needed, and the fact remains that most of the lower-middle income countries have several other alternative sources of finance to fund poverty reduction programs. Allocating funds away from the poorest countries (that have far fewer options) in favor of the richer countries is not the most optimal use of MCC funds.

Nevertheless, the MCC legislation states that the Corporation shall consider these countries as candidates for MCC assistance in 2006. The Board has the flexibility to determine which, if any, of these candidate countries will be eligible to submit proposals for assistance, and the authority to allocate from zero to up to 25% of appropriated funds for this set of countries.

These decisions were taken at a time when the administration and Congress were aiming to provide the MCC with \$5 billion in FY 2006, the first year the lower-middle income countries would become candidates. Now that the administration has scaled back its request to \$3 billion, the eligibility of these countries should be seriously reconsidered. With constrained budgets, and with many of the first year eligible countries not yet having reached the negotiation stage, the MCC should concentrate its efforts on the poorest countries and not expand to the middle income countries. The more limited funds available should be focused on the poorest countries. The size of the programs in the poorest countries should not be diluted by the addition of several lower-middle income countries to the list of eligible countries.

In considering the candidacy of these countries for 2006, the MCC Board should aim to make very few, if any, eligible to submit proposal during this start up phase. Ideally, at most one or two (if any) should be declared eligible, and the amount of funding available to them should be restricted so that they do not undermine the size of the programs in the poorer countries, where funding needs are more urgent. This part of the program could be gradually ramped up over time as funding and other constraints allow, so long as these richer countries do not detract funding from lower-income MCA eligible countries.

Chairman HYDE. Thank you.  
Dr. Gootnick.

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

Dr. GOOTNICK. Thank you, Mr. Chairman. Thank you for the opportunity to be here today to discuss GAO’s observations on the Millennium Challenge Corporation. Overall, consistent with Steve Radelet’s assessment, our assessment is that MCC has made progress in its first 15 months of operation, and, at the same time, it faces key challenges looking forward.

Today, I would like to discuss four aspects of MCC’s activities to date: First, its eligibility determinations; second, its progress in developing compacts; third, coordination issues; and, fourth, establishment of its corporate-wide management-and-accountability structures.

First, regarding country-eligibility determinations, in its first year, MCC developed a methodology, based on quantitative indicators, for making eligibility determinations. The board deemed 17 countries eligible for compact assistance, including three that did not meet their quantitative-indicator criteria. The board also selected 13 countries to participate in the corporation’s Threshold Program.

MCC’s public reports on the board’s eligibility determinations were brief and provided limited information. The reports did not explain the board’s rationale for not selecting 13 countries that met the indicator criteria. In general, our results thus far suggest that within the limits of, for example, classified and politically-sensitive

information, the more documentation that the corporation can provide that would explain and justify their determinations, the better off they would be in the long run.

Almost by definition, indicator-based methodologies have some limitations, and we have cited some of them in our report. MCC has stated that it will continue to refine its methodology in response to these and other limitations.

Next, Mr. Chairman, regarding MCC's progress in developing compacts, thus far, the corporation has received proposals from 16 eligible countries, and they tend to focus on things such as agribusiness, large-scale infrastructure, roads and ports, policy reforms, including public sector capacity building, amongst other things.

The corporation expects eligible countries to set priorities, consult broadly with civil society, and build on existing national-development strategies. Our work in Honduras found that their proposal is drawn largely from the poverty-reduction strategy paper in that country and, thus, would have the same strengths and limitations of the poverty-reduction strategy paper.

We also observed that they have engaged civil society with an active and ongoing debate regarding the selection of projects proposed by MCC.

From the discussion here this morning, it is clear that sufficiency of the consultative process may, indeed, be in the eye of the beholder and that while GAO has not specifically done the work to determine whether the consultative process was sufficient, the core principles articulated by GAO and others suggest that reaching a consensus on criteria, on what determines that consultation has been adequate, and then examining documentation that supports that consultative process against those criteria would serve MCC well in the long run.

MCC reports that it evaluates proposals' objectives, costs, and projected economic benefits. It also examines plans for fiscal management, procurement, and monitoring and evaluation of audit functions. Our prior work suggests that identifying host-country-based institutions that have the capacity to execute these functions would be a key challenge for MCC going forward.

Regarding coordination with key stakeholders, in an effort to leverage its small staff, the corporation has sought advice, resources, and assistance from several Federal agencies. USAID will implement the Threshold Program; Treasury, Agriculture; and the Army Corps of Engineers will assist and provide technical assistance to evaluate compact proposals. MCC has begun a dialogue with NGOs and other donors.

Finally, Mr. Chairman, regarding MCC's corporate-wide management and accountability structures, the corporation has developed key aspects of its administrative structures necessary to support its operation. For example, it has gone from 7 to over 100 employees in its first year. It has made some progress on structures needed to establish accountability and manage risk. For example, it established its investment committee. It also established an audit capability through its IG and has adopted bylaws to govern its activities.

However, on a range of key governance, internal control, and human capital structures, there remains some implementation to be done. For example, the corporation has not completed a strategic plan or an annual performance plan, and the board has not yet fully defined its roles and responsibilities regarding executing the corporation's corporate strategy. We are recommending that the corporation complete these overarching accountability structures.

In conclusion, Mr. Chairman, MCC has made considerable operational progress and has signed its first compact. Of note here, the corporation's 2006 budget justification estimates that it will finalize two to four compacts each quarter through the end of Fiscal Year 2006 and projects that future compacts will be considerably larger than the Madagascar compact.

Given these ambitious goals, we view MCC's completion of corporate-wide accountability structures as necessary to establish a viable and sustainable enterprise that effectively manages its institutional risk. Our recommendations are detailed in our written statement, and MCC has agreed to take these recommendations under consideration. We will continue to monitor the corporation's progress in this regard.

Mr. Chairman, this concludes my statement, which is also publicly available at the GAO Web site. I am happy to answer the Committee's questions.

[The prepared statement of Mr. Gootnick follows:]

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

United States Government Accountability Office

**GAO**

Testimony  
Before the Committee on International  
Relations, House of Representatives

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**MILLENNIUM  
CHALLENGE  
CORPORATION**

**Progress Made on Key  
Challenges in First Year of  
Operations**

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

Jeanette M. Franzel, Director  
Financial Management and Assurance



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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss GAO's findings and observations regarding the Millennium Challenge Corporation's (MCC) first year of operations.

In January 2004, Congress established MCC,<sup>1</sup> a government corporation, to administer the Millennium Challenge Account (MCA). MCC's mission is to provide development assistance that reduces extreme poverty through economic growth and strengthens good governance, economic freedom, and investments in people. MCC is to carry out its mission by funding projects or activities in developing countries that demonstrate a commitment to MCA objectives. MCC assistance is intended to supplement existing development assistance provided by the United States or other donors; to provide incentive, MCC aims to be among countries' largest donors. The Millennium Challenge Act of 2003 authorizes assistance in the form of grants, cooperative agreements, and contracts, which MCC will administer through compacts—agreements between the U.S. government and recipient countries' governments. Candidate countries are expected to develop compact proposals to secure MCA funding and manage MCC-funded projects.

The act requires the MCC Board of Directors to determine a country's eligibility for assistance, based, to the maximum extent possible, on objective and quantifiable indicators of the country's commitment to specific criteria set out in the act.<sup>2</sup> MCC is also required to provide to Congress justifications for the board's eligibility determinations and to coordinate its activities with those of the U.S. Agency for International Development (USAID). The act also authorizes MCC to help certain candidate countries achieve eligibility, which MCC does through its Threshold Program.<sup>3</sup> For fiscal years 2004 and 2005, Congress

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<sup>1</sup>Millennium Challenge Act of 2003, Public Law 108-199, Division D, Title VI of the Consolidated Appropriations Act, 2004. Also, Title II, Division D of this act established the Millennium Challenge Account for MCC appropriations.

<sup>2</sup>For fiscal years 2004 and 2005, MCC established an eligibility methodology that rates countries on 16 indicators, which are selected in part based on their objectivity and public availability. The indicators are arranged under the three policy categories—Ruling Justly, Investing in People, and Encouraging Economic Freedom. To be eligible, countries must score above the median on at least half of the indicators in each category and above the median on an indicator for combating corruption.

<sup>3</sup>The Threshold Program provides assistance to improve scores on the 16 indicators for candidate countries that are not deemed eligible but demonstrate a significant commitment to meeting MCC eligibility requirements.

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appropriated nearly \$1 billion and \$1.5 billion, respectively, for MCC; for fiscal year 2006, the President is requesting \$3 billion.

Today I will discuss MCC's activities during its first 15 months, specifically, its (1) process for determining country eligibility for fiscal years 2004-2005, (2) progress in developing compacts, (3) coordination with key stakeholders, and (4) establishment of management structures and accountability mechanisms.

To address these objectives, GAO analyzed MCC's process for determining country eligibility, including countries' scores for the quantitative indicators and the scores' source data for fiscal years 2004 and 2005; we also examined the selection criteria for the Threshold Program. We determined that these and other data that we used were sufficiently reliable for our analysis. In addition, we reviewed MCC documents, countries' compact proposals and an MCC compact, and reports by USAID and GAO. We conducted interviews with, among others, officials from MCC, U.S. government agencies, and nongovernmental organizations (NGOs), and we attended MCC public outreach meetings in Washington, D.C. In January 2005, we visited Honduras, one of four countries with which MCC was negotiating at that time, where we met with officials from the Department of State, USAID, MCC, and the Honduran government, as well as donor representatives and local NGOs. We performed our work between April 2004 and April 2005 in accordance with generally accepted government auditing standards. (See app. I for further details of our scope and methodology.)

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## Summary

The MCC Board of Directors based its determinations of countries' eligibility for MCA assistance on a quantitative indicator methodology, as required by the Millennium Challenge Act; at the same time, the process involved certain challenges. Applying its 16 quantitative indicators and exercising the discretion implicit in the act, the board selected a total of 17 countries as eligible for compact assistance for fiscal years 2004 and 2005. MCC did not provide Congress its justifications for the 13 countries that met the indicator criteria but were not deemed eligible; the Millennium Challenge Act does not require MCC to provide justifications for not selecting countries. In addition, although MCC published country scores for the 16 indicators at its Web site, some of the source data used to generate these scores were not readily available to the public. Our analysis of the results of MCC's eligibility determinations also revealed some inherent limitations of MCC's indicator methodology. For instance, measurement uncertainty may have affected the eligibility determination for 17 countries, and missing data for two indicators may have reduced the number of countries that passed the Economic Freedom category.

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MCC is refining the compact development process and has taken steps to identify country-level program implementation and fiscal accountability elements. Between August 2004 and March 2005, MCC received compact proposals, concept papers, or both, from 16 eligible countries. It signed a 4-year compact with Madagascar for \$110 million in April 2005 and is negotiating compacts with 4 other countries. MCC's compact with Madagascar would make it the country's fifth largest donor. MCC's compact development process currently involves the following steps:

(1) proposal development, (2) proposal submission and initial assessment, (3) detailed proposal assessment and negotiation, and (4) board review and compact signing. In addition, MCC has identified elements of a program implementation and fiscal accountability framework that can be adapted to eligible countries' compact objectives and institutional capacities.

MCC has initiated coordination of program activities with U.S. agencies, other donors, and U.S.-based NGOs. U.S. agencies represented on the MCC Board of Directors—USAID, the Departments of State and Treasury, and the Office of the U.S. Trade Representative (USTR)—have provided advice, resources, and assistance to MCC. In addition, MCC has signed agreements with five U.S. agencies for programmatic and technical assistance. Key bilateral and multilateral donors are providing information and expertise, such as country briefings and assessments, to MCC. In addition, MCC is consulting with some U.S.-based NGOs and has met with country-based NGOs. However, several U.S.-based NGOs have raised questions about the involvement of U.S.-based NGOs and country-based civil society groups.

MCC has made progress in establishing key management structures and elements of accountability mechanisms, but it has not yet developed essential corporatewide plans, strategies, and time frames. MCC's accomplishments in its first 15 months included setting up key administrative infrastructures to support its initial and ongoing program implementation, establishing an audit and review capability through its Inspector General (IG), adopting bylaws for its Board of Directors, providing ethics training to employees, and expanding its permanent full-time staff. However, MCC has not yet completed the plans, strategies, and time frames needed to establish corporatewide structures for accountability, governance, internal control, and human capital management. For example, the MCC board has not fully defined its responsibilities for overseeing corporate management, and MCC management has not yet completed its institutional infrastructure that aligns human capital planning and performance management with the corporation's goals and mission.

We recommend that MCC's Chief Executive Officer continue to develop and complete overall plans and related time frames to address corporatewide

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accountability, establish comprehensive internal control over program and administrative operations, and institute an effective human capital infrastructure. In addition, we recommend that the Secretary of State, in her capacity as Chair of the MCC Board of Directors, ensure that the board considers and defines the scope of its responsibilities with respect to corporate governance and oversight and develops an overall plan or strategy, with related time frames, for carrying out these responsibilities. In doing so, the board should consider, in addition to its statutory responsibilities, other corporate governance and oversight responsibilities commonly associated with sound and effective corporate governance practices. MCC provided technical comments on a draft of this report and agreed to take our recommendations under consideration.

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## Background

Each fiscal year, the Millennium Challenge Act requires MCC to select countries as eligible for MCA assistance by identifying candidate countries, establishing an eligibility methodology, and making eligibility determinations. MCC evaluates eligible countries' proposals and negotiates compacts, which must be approved by the MCC board. The Threshold Program assists countries that are not deemed eligible but show a commitment to MCA objectives. MCC is governed by a board of directors consisting of U.S. government and other representatives.

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## Candidate Countries

For fiscal year 2004, the Millennium Challenge Act limited candidates to low-income countries—those with per capita incomes less than or equal to the International Development Association (IDA) cutoff for that year (\$1,415)—that also were eligible for IDA assistance.<sup>4</sup> This provision limited candidacy in the MCA's first year to the poorest low-income countries. For fiscal year 2005, candidates were required only to have incomes less than or equal to the IDA ceiling for that year (\$1,465).<sup>5</sup> Additionally, for fiscal years 2004 and 2005,

<sup>4</sup>The IDA, an arm of the World Bank Group, provides long-term interest-free loans and grants to the poorest developing countries with limited access to private sources of capital.

<sup>5</sup>For fiscal year 2006 and beyond, the Millennium Challenge Act requires that candidates for MCA assistance (1) be either low-income or lower-middle-income countries and (2) not be ineligible for U.S. economic assistance under the Foreign Assistance Act of 1961. The act defines lower-middle-income countries as those classified as such by the World Bank with incomes above the IDA ceiling. MCA assistance to the lower-middle-income countries may not exceed 25 percent of the total amount of assistance to all countries for that year.



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candidates could not be ineligible for U.S. economic assistance under the Foreign Assistance Act of 1961. (See app. II for a list of candidate countries for fiscal years 2004 and 2005.)

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#### Eligibility Determinations

The Millennium Challenge Act requires that the MCC board base its eligibility decisions, “to the maximum extent possible,” on objective and quantifiable indicators of a country’s demonstrated commitment to the criteria enumerated in the act. MCC selected its indicators based on their relationship to growth and poverty reduction, the number of countries they cover, their transparency and public availability, and their relative soundness and objectivity.<sup>6</sup>

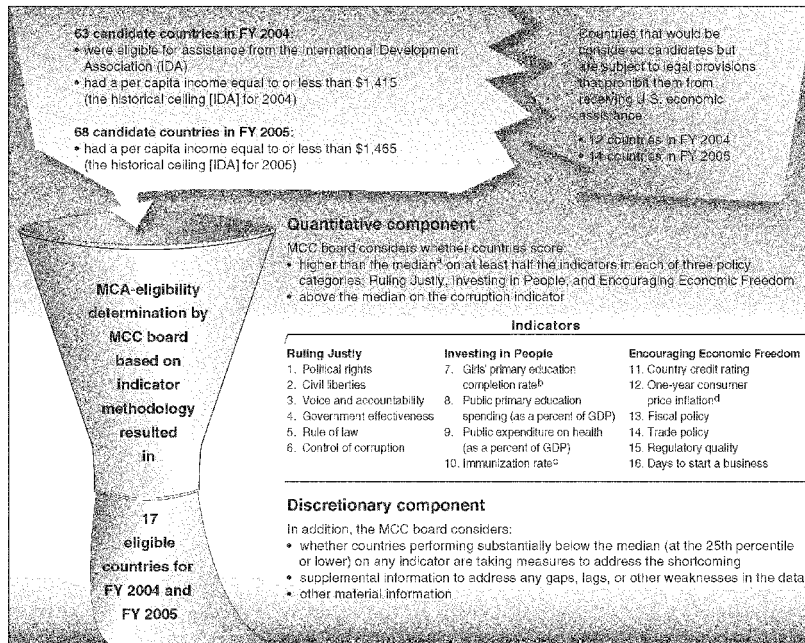
For fiscal years 2004 and 2005, MCC’s process for determining country eligibility for MCA assistance had both a quantitative and a discretionary component (see fig. 1). MCC first identified candidate countries that performed above the median in relation to their peers on at least half of the quantitative indicators in each of the three policy categories—Ruling Justly, Investing in People, and Encouraging Economic Freedom—and above the median on the indicator for control of corruption. (See app. III for a table describing the indicators, listing their sources, and summarizing the methodologies on which they are based.) In addition, MCC considered other relevant information—in particular, whether countries that scored substantially below the median (at the 25th percentile or lower) on an indicator were addressing any shortcomings related to that indicator. MCC also considered supplemental information to address gaps, lags, or other data weaknesses as well as additional material information.<sup>7</sup>

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<sup>6</sup>See Millennium Challenge Corporation, “Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in FY 2004, Annex A: Indicator Definitions” (available at: [http://www.mca.gov/about\\_us/congressional\\_reports/index.shtml](http://www.mca.gov/about_us/congressional_reports/index.shtml)).

<sup>7</sup>MCC’s fiscal year 2004 and 2005 methodology reports state that, where the act stipulates criteria for which there is limited quantitative information (e.g., rights of people with disabilities) or no well-developed performance indicator (e.g., sustainable management of natural resources), the MCC board relies on supplemental data and qualitative information such as State Department Human Rights reports, access to sanitation, deforestation, and trade in endangered species.

Figure 1: MCC's Process for Determining Country Eligibility



Source: GAO analysis of MCC selection process.

<sup>a</sup>The fiscal year 2004 and 2005 medians for the 16 indicators were based on the scores of all countries meeting the income criteria, including those countries that are ineligible to receive U.S. economic assistance under the Foreign Assistance Act.

<sup>b</sup>For fiscal year 2004, MCC used the Primary Education Completion Rate.

<sup>c</sup>Average of immunization rates for DPT3—diphtheria, pertussis and tetanus—and measles.

<sup>d</sup>For the consumer price inflation indicator, countries are not required to score higher than the median; instead, inflation rates must not exceed 20 percent for fiscal year 2004 or 15 percent for fiscal year 2005.

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The Millennium Challenge Act requires that, within 5 days of the board's eligibility determinations, the MCC Chief Executive Officer submit a report to congressional committees containing a list of the eligible countries and "a justification for such eligibility determination" and publish the report in the *Federal Register*.

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#### MCA Compacts

Eligible countries are invited to submit compact proposals, which are to be developed in consultation with members of civil society, including the private sector and NGOs. However, a country's eligibility does not guarantee that MCC will sign and then fund a compact with that country. MCC is to sign compacts only with national governments.<sup>8</sup> Under the act, the duration of compacts is limited to a maximum of 5 years; MCC expects to approve compacts with durations of 3 to 5 years. MCA funds are not earmarked for specific projects or countries, and money not obligated in the fiscal year for which it was appropriated can be used in subsequent fiscal years. For fiscal years 2004 and 2005, Congress has directed that MCC use its existing appropriations to fully fund a compact—that is, obligate the entire amount anticipated for the compact's duration.<sup>9</sup> Funding for compacts and the Threshold Program must be drawn from the appropriation for the fiscal year in which the country was eligible. MCC aims to be among the largest donors in recipient countries, which, according to MCC officials, creates incentive for eligible countries to "buy into" MCC's principles of policy reform, sustainable economic growth, country partnership, and results.

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#### Threshold Program

The Millennium Challenge Act authorizes a limited amount of assistance to certain candidate countries to help them become eligible for MCA assistance. These candidate countries must (1) meet the fiscal year 2004 or 2005 requirements for MCA candidacy and (2) demonstrate a significant commitment to meeting the act's eligibility criteria but fail to meet those requirements.<sup>10</sup> MCC

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<sup>8</sup>The Millennium Challenge Act authorizes assistance to the national government of an eligible country, regional or local governmental units of the country, or a nongovernmental organization or private entity.

<sup>9</sup>The Consolidated Appropriations Act, 2005, provides that funds appropriated for MCC for fiscal years 2004 and 2005 are available for compacts only if the compacts obligate, or commit to obligate (subject to availability of funds and agreement of the parties), the entire amount anticipated for the compact's duration. See Public Law 108-447, Division D, Title II, 118 Stat. 2809, 2980.

<sup>10</sup>The act limited this type of assistance to 10 percent of MCA's fiscal year 2004 appropriations. The Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2005, limited this type of assistance to 10 percent of fiscal year 2005 appropriations. Future funding for this type of assistance will be determined by legislation in subsequent years.

has implemented these legislative provisions as its Threshold Program. Figure 2 compares features of MCC compact and Threshold Program assistance; appendix IV describes the Threshold Program.

Figure 2: Comparison of MCC Compact Assistance and Threshold Program

	MCC compact assistance	Threshold Program
<b>Program goal</b>	Poverty reduction through economic growth.	Improvement in eligibility indicators that are central to MCC's selection methodology. <sup>a</sup>
<b>Total funding available</b>	\$954 million in FY 2004 and \$1.35 billion in FY 2005. <sup>b</sup>	\$40 million in FY 2004 and up to \$150 million in FY 2005. <sup>c</sup>
<b>Application deadline</b>	No deadline for concept paper or proposal submission.	Concept papers due by January 31, 2005 for FY 2004 and March 15, 2005 for FY 2005; no deadline for detailed plan.
<b>Proposal development</b>	Consultative process involving civil society organizations, private sector, etc., is required.	No consultative process required.
<b>Program duration</b>	Approved compacts to be funded for up to 5 years.	Approved threshold plans will be funded for up to 2 years, though exceptions may be made.
<b>Program management</b>	Country oversight entity will be accountable to MCC.	USAID will manage Threshold Program with MCC oversight.
<b>Country role</b>	Countries propose economic development and poverty reduction priorities and negotiate compacts with MCC.	Countries are expected to propose programs that address weaknesses that may have caused them to fail the eligibility indicators.

Source: GAO synthesis of MCC information.

<sup>a</sup>According to MCC, participation in the Threshold Program does not guarantee future eligibility for compact assistance.

<sup>b</sup>Includes funds for administrative expenses but excludes \$40 million set aside for fiscal year 2004 and \$150 million (up to 10 percent of total MCC appropriations) in fiscal year 2005 for the Threshold Program. As of April 2005, MCC had not determined the amount of funding set aside for the fiscal year 2005 Threshold Program.

<sup>c</sup>The MCC board could authorize additional Threshold Program funding of up to 10 percent (\$96.4 million) of fiscal year 2004 MCC appropriations.

**MCC Governance**

MCC has broad authority under the Millennium Challenge Act to enter into contracts and business relationships. The act establishes the MCC Board of Directors and assigns it a key decision-making role in the corporation's activities, including those related to implementing the compact program. The act also makes provisions for the board to consult with Congress and provide general

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supervision of MCC's IG.<sup>11</sup> The board consists of the Secretary of State (Board Chair), the Secretary of the Treasury (Vice Chair), the USAID Administrator, and the U.S. Trade Representative, in addition to MCC's Chief Executive Officer. The board has four other positions filled by Presidential appointment with the approval of the Senate. Two of these positions have been filled. (For a timeline of key events and milestones since MCC's launch, see app. V.)

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**MCC Used Quantitative Indicators and Judgment to Determine Country Eligibility; Process Involves Ongoing Challenges**

For fiscal years 2004 and 2005, the MCC board based its determinations of countries' eligibility on its quantitative indicator methodology as well on discretion. Although MCC published the countries' indicator scores at its Web site, some of the indicator source data used to generate the scores were not readily available. Finally, we found that reliance on the indicators carried certain inherent limitations.

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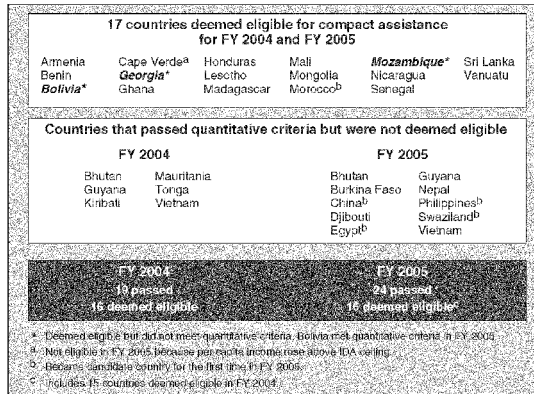
**MCC Used Quantitative Indicators and Judgment to Determine Eligibility**

MCC used the 16 quantitative indicators, as well as the discretion implicit in the Millennium Challenge Act, to select 17 countries as eligible for MCA compact assistance for fiscal years 2004 and 2005 (see fig. 3).

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<sup>11</sup>Public Law 108-199 designated the USAID Office of the Inspector General as MCC's IG.

**Figure 3: MCA Eligibility Determinations for Fiscal Years 2004 and 2005**



Source: GAO analysis of MCC data.

- 1 **Fiscal year 2004:** In May 2004, the MCC board selected 16 countries as eligible for fiscal year 2004 funding. The countries deemed eligible include 13 that met the quantitative indicator criteria and 3 that did not (Bolivia, Georgia, and Mozambique). Another 6 countries met the criteria but were not deemed eligible.
- 1 **Fiscal year 2005:** In October 2004, the MCC board selected 16 countries as eligible for fiscal year 2005 funding. The countries deemed eligible included 14 countries that met the indicator criteria and 2 countries that did not (Georgia and Mozambique). Ten countries met the criteria but were not deemed eligible. Fifteen of the 16 countries also had been deemed eligible for fiscal year 2004;<sup>12</sup> the only new country was Morocco.

<sup>12</sup>Cape Verde, eligible in fiscal year 2004, was not a candidate in fiscal year 2005.

MCC did not provide Congress its justifications for the 13 countries that met the indicator criteria but were not deemed eligible for fiscal years 2004 and 2005 (one of these countries, Tonga, did not score substantially below the median on any indicator).<sup>13</sup> The act does not explicitly require MCC to include a justification to Congress for why these countries were not deemed eligible.

In addition, our analysis of countries that met the indicator criteria but were not deemed eligible suggests that, besides requiring that a country score above the median on the indicator for control of corruption, MCC placed particular emphasis on three Ruling Justly indicators (political rights, civil liberties, and voice and accountability) in making its eligibility determinations. In fiscal years 2004 and 2005, 6 of the 13 countries that met the indicator criteria but were not deemed eligible had scores equal to or below the median on these three indicators.<sup>14</sup> On the other hand, the 13 countries that were not deemed eligible performed similarly to the eligible countries on the other three Ruling Justly indicators—government effectiveness, rule of law, and control of corruption—as well as on the indicators for Investing in People and Encouraging Economic Freedom.

**Not All Source Data for  
Quantitative Indicators Were  
Publicly Accessible**

Although MCC published its country scores for all of the indicators at its Web site,<sup>15</sup> some of the indicator source data used to generate the scores were not readily available to the public. We found that source data for nine of the indicators<sup>16</sup> were accessible via hyperlinks from MCC's Web site, making it

<sup>13</sup>According to GAO analysis, 12 of the countries deemed eligible in fiscal years 2004 and 2005 met the indicator criteria but scored substantially below the median (25th percentile or lower) on one or two indicators. MCC's reports to Congress listed 4 countries that scored substantially below the median (Cape Verde, Lesotho, Morocco, and Sri Lanka). MCC provided justification for selecting as eligible these 4 countries, but it did not provide justification for selecting the remaining 8 countries.

<sup>14</sup>The 6 countries that scored low on the three governance indicators are Bhutan, China, Djibouti, Egypt, Swaziland, and Vietnam. The 13 countries that passed the indicators but were not selected are Bhutan (2004 and 2005), Burkina Faso (2005), China (2005), Djibouti (2005), Egypt (2005), Guyana (2004 and 2005), Kiribati (2004), Mauritania (2004), Nepal (2005), Philippines (2005), Swaziland (2005), Tonga (2004), and Vietnam (2004 and 2005). Six of these countries—China, Djibouti, Egypt, Nepal, Swaziland, and Vietnam—also scored low on trade policy relative to the MCA-eligible countries.

<sup>15</sup>MCC officials told us that, owing to staffing constraints, MCC did not post updated indicator data before the board's fiscal year 2004 eligibility decisions. Having added more staff, MCC posted the updated data prior to the board's fiscal year 2005 decisions.

<sup>16</sup>Source data for voice and accountability, government effectiveness, rule of law, control of corruption, and regulatory quality were from the World Bank Institute; for trade policy, from the Heritage Foundation; for civil liberties and for political rights, from Freedom House; and for country credit rating, from Institutional Investor.

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possible to compare those data with MCC's published country scores. However, for the remaining seven indicators, we encountered obstacles to locating the source data, without which candidate countries and other interested parties would be unable to reproduce and verify MCC's results.

- **Primary education completion rates:** The published indicators were created with data from several sources and years, and not all of these data were available on line.
- † **Primary education and health spending (percentage of gross domestic product):** When national government data were unavailable, MCC used either country historical data or data from the World Bank to estimate current expenditures.
- Ⓐ **Diphtheria and measles immunization rate:** The general hyperlink at the MCC Web site did not link to the data files used to create the published indicators.<sup>17</sup>
- Ⓐ **One-year consumer price inflation:** The published indicators were created with a mix of data from several data sources and different years.
- **Fiscal policy:** The published indicators were created with International Monetary Fund (IMF) data that are not publicly available.
- † **Days to start a business:** Updated indicators were not published until after the board had made its fiscal year 2004 eligibility decisions.

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<sup>17</sup>MCC officials told us that they use general hyperlinks to prevent users from linking to outdated Web addresses.



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### Use of Quantitative Indicators Had Some Inherent Limitations

MCC's use of the quantitative indicator criteria in the country selection process for fiscal years 2004 and 2005 involved the following inherent difficulties:

- I Owing to measurement uncertainty, the scores of 17 countries may have been misclassified as above or below the median.<sup>18</sup> In fiscal years 2004 and 2005, 7 countries did not meet the quantitative indicator criteria because of corruption scores below the median, but given measurement uncertainty their true scores may have been above the median. Likewise, 10 countries met the indicator criteria with corruption scores above the median, but their true scores may have been below the median.<sup>19</sup>
- Missing data for the days to start a business and trade policy indicators reduced the number of countries that could achieve above-median scores for those indicators. For fiscal years 2004 and 2005, 20 and 22 countries, respectively, lacked data for the indicator for days to start a business, and 18 and 13 countries, respectively, lacked data for the trade policy indicator. Our analysis suggests that missing data for these two indicators may have reduced the number of countries that passed the Encouraging Economic Freedom category.
- I The narrow and undifferentiated range of possible scores for the political rights, civil liberties, and trade policy indicators led to clustering—"bunching"—of scores around the median, making the scores less useful in distinguishing among countries' performances. In fiscal year 2005, for example, 46 countries, or two-thirds of the countries with trade policy data, received a score of 4 (the median) or 5 (the lowest score possible) for trade policy. Our analysis suggests that bunching potentially reduced the number of countries that passed the Ruling Justly and Economic Freedom categories and limited MCC's ability to determine whether countries performed substantially below their peers in affected indicators.

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<sup>18</sup>Measurement uncertainty, or margin of error, makes it difficult in many cases to say with accuracy where a country's true score lies. Measurement uncertainty applies to virtually all indicators, including the World Bank Institute's governance indicators. The World Bank team that created the corruption and other governance indicators cautioned that special scrutiny should be given to borderline cases, saying that "for one-third of the potentially MCA-eligible countries, there is at least a 25 percent chance they will be mistakenly classified as below the median when they should be above, and vice versa." See Daniel Kaufmann and Aart Kraay, *Governance Indicators, Aid Allocation, and the Millennium Challenge Account: A Summary* (Washington, D.C.: The World Bank, December 2002).

<sup>19</sup>According to MCC officials, the board also used Transparency International's (TI) Corruption Perceptions Index as a secondary corruption source. However, 11 scores were not available for all the fiscal years 2004 and 2005 candidate countries.

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With respect to the indicator for control of corruption, countries deemed eligible for MCA compact assistance represent the best performers among their peers; at the same time, studies have found that, in general, countries with low per capita income also score low on corruption indexes. Of the 17 MCA compact eligible countries, 11 ranked below the 50th percentile among the 195 countries rated by the World Bank Institute for control of corruption; none scored in the top third.

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### MCC Is Refining Its Compact Development Process

MCC has received compact proposals, concept papers, or both, from 16 countries; of these, it has approved a compact with one country and is negotiating with four others. At the same time, MCC continues to refine its process for reviewing and assessing compact proposals. As part of this process, MCC has identified elements of country program implementation and fiscal accountability that can be adapted to eligible countries' compact objectives and institutional capacities.

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### MCC Has Received a Number of Proposals and Is Negotiating Several Compacts

Between August 2004 and March 2005, MCC received compact proposals, concept papers, or both, from 16 MCA compact-eligible countries, more than half of which submitted revised proposal drafts in response to MCC's assessments.<sup>20</sup> In March 2005, MCC approved a 4-year compact with Madagascar for \$110 million to fund rural projects aimed at enhancing land titling and security, increasing financial sector competition, and improving agricultural production technologies and market capacity; MCC and Madagascar signed the compact on April 18, 2005. MCC is negotiating compacts with Cape Verde, Georgia, Honduras, and Nicaragua<sup>21</sup> and is conducting in-depth assessments of proposals from two additional countries. Figure 4 summarizes the types of projects that eligible countries have proposed and that MCC is currently reviewing.

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<sup>20</sup>MCC encourages countries to submit concept papers, outlines, or other documentation for guidance and feedback before submitting initial proposals.

<sup>21</sup>MCC has notified appropriate congressional committees of its intent to enter into negotiations with these countries.

Figure 4: Types of Proposed Projects under MCC Review

	Agribusiness <sup>a</sup>	Business <sup>b</sup>	Education and health	Energy	Finance and credit	Land lining	Policy reform <sup>c</sup>	Transportation infrastructure <sup>d</sup>	Water management <sup>e</sup>	Water sanitation
Armenia	•									
Benin	•					•	•	•		
Bolivia	•	•	•	•			•	•	•	
Cape Verde	•	•	•	•			•	•		
Georgia	•	•		•			•	•	•	
Ghana	•			•	•		•	•		
Honduras	•			•			•			
Lesotho							•	•		
Madagascar <sup>f</sup>	•			•	•					
Mali	•						•	•		
Mongolia	•	•		•			•	•		
Mozambique	•	•	•	•			•	•	•	
Nicaragua	•	•	•	•			•	•	•	
Senegal	•			•			•	•		
Sri Lanka	•	•	•	•			•	•	•	
Vanuatu							•	•		

Source: GAO summary and analysis of MCC data as of April 30, 2005.

Note: Dots indicate that one or more projects may be categorized as shown and are not intended to quantify the number of projects a country has proposed or the number of projects in a category.

<sup>a</sup>Agribusiness<sup>a</sup> includes agricultural production, processing, marketing, and other projects.

<sup>b</sup>Business<sup>b</sup> includes projects related to nonagricultural business development (e.g., tourism and industrial parks).

<sup>c</sup>Policy reform<sup>c</sup> also includes assistance for public sector capacity-building. According to MCC officials, all compacts will contain project-related policy reform elements, some of which may receive funding.

<sup>d</sup>Transportation infrastructure<sup>d</sup> includes road, port, and airport planning, construction, and upgrading.

<sup>e</sup>Water management<sup>e</sup> includes construction and upgrading of dams, irrigation systems, and water reservoirs, among other things.

<sup>f</sup>MCC approved Madagascar's compact in March 2005; MCC and Madagascar signed the compact on April 18, 2005.

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The countries' initial proposals and concept papers requested about \$4.8 billion; those that MCC is currently reviewing (see fig. 4) and negotiating request approximately \$3 billion over 3 to 5 years. Our analysis—based on MCC's goal of being a top donor as well as Congress's requirement that the corporation fund compacts in full—shows that the \$2.4 billion available from fiscal year 2004 and 2005 appropriations will allow MCC to fund between 4 and 14 compacts, including Madagascar's compact, for those years.<sup>22</sup> MCC's \$110 million compact with Madagascar, averaging \$27.5 million per year, would make it the country's fifth largest donor (see app. VI for a list of the largest donors to MCA compact-eligible countries in fiscal years 2002-2003).<sup>23</sup>

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#### MCC Continues to Refine Its Compact Development Process

As of April 2005, MCC is continuing to refine its process for developing compacts. According to MCC officials, the compact development process is open ended and characterized by ongoing discussions with eligible countries. According to a recent IG report, MCC's negotiating a compact with Madagascar has served as a prototype for completing compacts with other countries.<sup>24</sup> At present, the compact proposal development and assessment process follows four steps (see fig. 5).

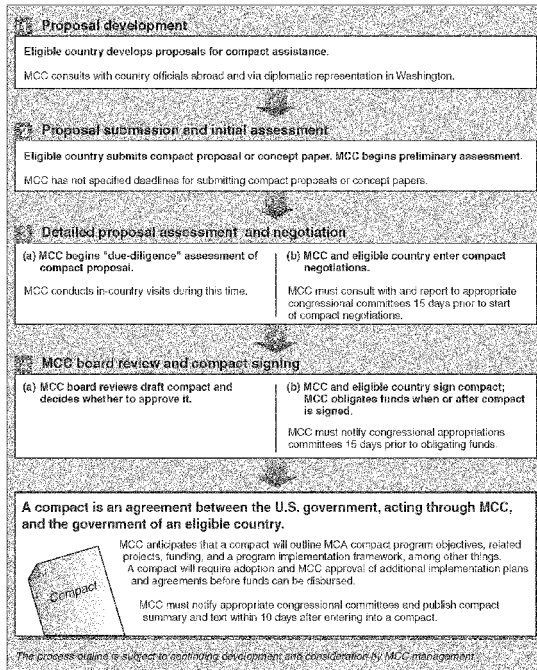
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<sup>22</sup>The lower estimated number of compacts assumes that MCC funds 5-year compacts at a level equal to the average annual assistance provided by the largest donor in the 17 countries that were eligible in fiscal years 2004 and 2005 (about \$109 million). The higher estimate assumes that MCC funds 3-year compacts at a level equal to the average annual assistance provided by the third largest donor in these countries (about \$60 million).

<sup>23</sup>Based on OECD net official development assistance (ODA) data. OECD defines ODA as grants or loans to developing countries undertaken by the official sector (a) with the promotion of economic development and welfare as the main objective and (b) if a loan, having a grant element of at least 25 percent.

<sup>24</sup>Office of Inspector General, *Review of Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs As of February 28, 2005* (Washington, D.C.: March 2005).

**Figure 5: MCC's Compact Development Process**



Source: GAO analysis and synthesis of MCC's compact development process.

**Step 1: Proposal development.** MCC expects eligible countries to propose projects and program implementation structures, building on existing national economic development strategies. For instance, the Honduran government's

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proposal is based on its Poverty Reduction Strategy Paper (PRSP)<sup>25</sup> and a subsequent June 2004 implementation plan.<sup>26</sup> MCC also requires that eligible countries use a broad-based consultative process to develop their proposals.<sup>27</sup> MCC staff discuss the proposal with country officials during this phase of compact development. Although MCC does not intend to provide funding to countries for proposal development,<sup>28</sup> some countries have received grants from regional organizations for proposal development.<sup>29</sup>

**Step 2: Proposal submission and initial assessment.** Eligible countries submit compact proposals or concept papers. MCC has not specified deadlines for proposal submission or publicly declared the limits or range of available funding for individual compacts. According to MCC officials, the absence of deadlines and funding parameters permits countries to take initiative in developing proposals. However, according to U.S.-based NGOs, the lack of deadlines has caused some uncertainty and confusion among eligible country officials. Honduran officials told us that knowing a range of potential funding would have enhanced their ability to develop a more focused proposal.

During this stage, MCC conducts a preliminary assessment of the proposal, drawing on its staff, contractors, and employees of other U.S. government agencies. This assessment examines the potential impact of the proposal's strategy for economic growth and poverty reduction, the consultative process used to develop the proposal, and the indicators for measuring progress toward the proposed goals. According to MCC, some eligible countries have moved quickly to develop their MCC programs. Others initially were unfamiliar with MCC's approach and some faced institutional constraints. MCC works with these

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<sup>25</sup>The World Bank and IMF require countries to develop participatory poverty reduction strategies as a condition for receiving assistance. These strategies, which are outlined in countries' PRSPs, provide the basis for World Bank and IMF concessional lending and debt relief.

<sup>26</sup>Republic of Honduras, *Attaining the Goals of the Poverty Reduction Strategy: Implementation Plan for 2004-2006. Consultative Group Meeting for Honduras, Tegucigalpa M.D.C., June 10-11, 2004* (Tegucigalpa: 2004).

<sup>27</sup>The Millennium Challenge Act, Sec. 609(d), requires the United States, in entering into a compact, to ensure that eligible countries consider the perspectives of rural and urban poor, including women, and consult with private and voluntary organizations, the business community, and other donors.

<sup>28</sup>The Millennium Challenge Act, Sec. 609(g), authorizes MCC to enter into contracts with, or make grants to, eligible countries to facilitate compact development and implementation.

<sup>29</sup>For example, Mongolia has received assistance from The Asia Foundation to develop its proposal. In addition, Honduras and Nicaragua have received separate grants from the Central American Bank for Economic Integration (CABEI) and Inter-American Development Bank (IDB).

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countries to develop programs that it can support. In addition, MCC is exploring ways—such as providing grants—to facilitate compact development and implementation. Once MCC staff determine that they have collected sufficient preliminary information, they seek the approval of MCC’s Investment Committee<sup>30</sup> to conduct a more detailed analysis, known as due diligence.

**Step 3: Detailed proposal assessment and negotiation.** MCC’s due diligence review includes an analysis of the proposed program’s objectives and its costs relative to potential economic benefits.<sup>31</sup> Among other things, the review also examines the proposal’s plans for program implementation, including monitoring and evaluation; for fiscal accountability; and for coordination with USAID and other donors. In addition, the review considers the country’s commitment to MCC eligibility criteria and legal considerations pertaining to the program’s implementation.<sup>32</sup> During their review, MCC staff seek the approval of the Investment Committee to notify Congress that the corporation intends to initiate compact negotiations; following completion of the review, MCC staff request the committee’s approval to enter compact negotiations. When the negotiations have been concluded, the Investment Committee decides whether to approve submission of the compact text to the MCC board.

**Step 4: Board review and compact signing.** The MCC board reviews the compact draft. Before the compact can be signed and funds obligated, the board must approve the draft and MCC must notify appropriate congressional committees of its intention to obligate funds.

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<sup>30</sup>The Investment Committee comprises MCC’s CEO and vice presidents.

<sup>31</sup>MCC’s cost-benefit analysis identifies, among other things, potential economic benefits and intended beneficiaries, as well as financial and nonfinancial (e.g., environmental impact) project costs. Previous GAO work on the Global Fund to Fight AIDS, TB and Malaria identified technical review of grant proposals as a challenging aspect of its operations. See U.S. Government Accountability Office, *Global Health: Global Fund to Fight AIDS, TB and Malaria Has Advanced in Key Areas, but Difficult Challenges Remain*, GAO-05-601 (Washington, D.C.: May 7, 2003).

<sup>32</sup>According to MCC documents, the legal considerations include the country’s statutory requirements for compact approval and enforcement; Millennium Challenge Act section 605 prohibitions (i.e., military assistance and training, assistance relating to U.S. job loss or production displacement, assistance relating to environmental, health, or safety hazards, and use of funds for abortions and involuntary sterilizations), and exemption MCA assistance from taxation or reimbursement of such taxation.

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MCC Has Identified Elements of Program Implementation and Fiscal Accountability Framework

MCC has identified several broadly defined elements of program implementation and fiscal accountability that it considers essential to ensuring achievement of compact goals and proper use of MCC funds. As signatories to the compact, MCC and the country government will be fundamental elements of this framework. However, MCC and eligible countries can adapt other elements (see fig. 6) by assigning roles and responsibilities to governmental and other entities according to the countries' compact objectives and institutional capacities.<sup>33</sup> Madagascar's compact incorporates these elements in addition to an advisory council composed of private sector and civil society representatives, as well as local and regional government officials. The compact also requires that MCA-Madagascar, the oversight entity, adopt additional plans and agreements before funds can be disbursed, including plans for fiscal accountability and procurement. In addition, the compact requires the adoption of a monitoring and evaluation plan; provides a description of the plan's required elements; and establishes performance indicators for each of Madagascar's three program objectives, which are linked to measures of the program's expected overall impact on economic growth and poverty reduction. MCC expects to disburse funds in tranches as it approves Madagascar's completed plans and agreements. According to the IG, MCC officials expect to make the initial disbursements within 2 months after signing the compact.<sup>34</sup>

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<sup>33</sup>Many poor countries have weak, inefficient, and sometimes corrupt institutions that resist reform. See, for example, U.S. Government Accountability Office, *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges*, GAO/NSIAD-00-161 (Washington, D.C.: June 2000). Also see C.I.C.E./Deloitte, *Senegal "MCA Jumpstart": Strengthening Planning and Management Systems to Support Accelerated Development in Senegal, "MCA Jumpstart" Summary Report, Phase 1* (Dakar, Senegal: USAID, January 2004) and C.I.C.E./Deloitte, *Senegal MCA Jumpstart Phase 2: Overcoming Absorptive Capacity Constraints* (Dakar, Senegal: USAID, November 2004).

<sup>34</sup>Previous GAO work suggests that countries' effective use of development assistance may depend on their abilities to establish the necessary institutions for identifying projects and distributing funds. See, for example, our 2003 report on the Global Fund to Fight AIDS, TB and Malaria (GAO-03-601).



**Figure 6: Adaptable Elements of MCC's Framework for Program Implementation and Fiscal Accountability**

Entity	Key roles/responsibilities	Governmental examples	Other examples
Country oversight entity	<ul style="list-style-type: none"> <li>Oversees and manages program and projects</li> <li>Contracts with fiscal and procurement agents, project implementers, and auditors and reviewers</li> <li>Approves contract actions and requests for payment</li> </ul>	<ul style="list-style-type: none"> <li>Prime minister's office</li> <li>Ministry</li> </ul>	<ul style="list-style-type: none"> <li>Separate legal entity (e.g., council or committee) with government, civil society, and private sector representation</li> <li>Private company</li> </ul>
Fiscal agent	<ul style="list-style-type: none"> <li>Bank account signatory</li> <li>Documents transactions and authorizes reimbursement requests</li> <li>Provides accounting and financial reports</li> </ul>	<ul style="list-style-type: none"> <li>Finance ministry</li> </ul>	<ul style="list-style-type: none"> <li>Donor agency</li> <li>Accounting firm</li> <li>Commercial bank</li> <li>NGO</li> </ul>
Procurement agent	<ul style="list-style-type: none"> <li>Administers and/or certifies procurement process</li> </ul>	<ul style="list-style-type: none"> <li>Ministries</li> </ul>	<ul style="list-style-type: none"> <li>Donor unit</li> <li>Accounting firm</li> <li>Private company</li> <li>NGO</li> </ul>
Bank account	<ul style="list-style-type: none"> <li>Dedicated to MCC funds</li> </ul>	<ul style="list-style-type: none"> <li>Central bank</li> </ul>	<ul style="list-style-type: none"> <li>Commercial bank</li> </ul>
Project implementer(s)	<ul style="list-style-type: none"> <li>Implements projects specified in the country's compact</li> <li>Requests payments from the oversight entity</li> <li>Certifies delivery and receipt of goods and services</li> </ul>	<ul style="list-style-type: none"> <li>Ministries</li> </ul>	<ul style="list-style-type: none"> <li>Donor unit</li> <li>Private company</li> <li>NGO</li> </ul>
Auditors and reviewers	<ul style="list-style-type: none"> <li>Conducts financial audits, performance and compliance reviews, and data quality assessments</li> </ul>	<ul style="list-style-type: none"> <li>Supreme Audit Institution</li> <li>Statistics institute</li> </ul>	<ul style="list-style-type: none"> <li>Accounting firm</li> <li>Consulting firm</li> <li>Academic institution</li> <li>NGO</li> </ul>

Source: GAO synthesis of MCC information.

### MCC Is Taking Steps to Coordinate with Key Stakeholders

MCC has received advice and support from USAID, State, Treasury, and USTR and has signed agreements with five U.S. agencies for program implementation and technical assistance. In addition, MCC is consulting with other donors in Washington, D.C., and in the field to use existing donor expertise. MCC is also consulting with U.S.-based NGOs as part of its domestic outreach effort; however, some NGOs raised questions about the involvement of civil society groups. (See app. VII for more details of MCC's coordination efforts.)

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U.S. Agencies Are  
Contributing Resources and  
Technical Assistance

MCC initially coordinated primarily with U.S. agencies on its board and is expanding its coordination efforts to leverage the expertise of other agencies. USAID and the Department of State in Washington, D.C., and in compact-eligible countries, have facilitated meetings between MCC officials and donors and representatives of the private sector and NGOs in eligible countries. In addition, several of the six USAID missions contacted by GAO reported that their staff had provided country-specific information, had observed MCC-related meetings between civil society organizations and governments, or had informed other donors about MCC. MCC has also coordinated with the Department of the Treasury and USTR. For example, according to MCC officials, MCC has regularly briefed these agencies on specific elements of compact proposals and established an interagency working group to discuss compact-related legal issues.

Since October 2004, MCC has expanded its coordination through formal agreements with five U.S. agencies, including the Census Bureau, Army Corps of Engineers, and Department of Agriculture, that are not on the MCC board. MCC has obligated more than \$6 million for programmatic and technical assistance through these agreements, as shown in figure 7.

Figure 7: Agreements between MCC and U.S. Agencies

U.S. agency	Purpose	Funds obligated to agency	Agreement date and duration
U.S. Agency for International Development	Implement the Threshold Program, with MCC maintaining oversight and ultimate decision-making authority. (See app. IV for a detailed description of the program.)	USAID will charge MCC a flat administrative fee of 7 percent of funding that USAID obligates for the Threshold Program.	October 2004 Indefinite duration <sup>a</sup>
	Provide grant or enter into an agreement with Government of Madagascar for the performance, completion and delivery of baseline statistical data that will be used to assess the impact of the Madagascar Compact.	\$1,300,000	March 2005 1-year duration
U.S. Department of the Treasury's Office of Technical Assistance	Assist in evaluating fiscal and financial aspects of MCC funded programs including ongoing oversight, monitoring and technical assistance in the areas of financial management as may be required for the execution of MCC Compacts.	\$1,200,000 <sup>b</sup>	February 2005 5-year duration
U.S. Army Corps of Engineers	Assist with evaluations of infrastructure projects proposed by MCC-eligible countries.	\$1,500,000 <sup>b</sup>	February 2005 5-year duration
	Evaluate roads project in Honduras.	\$192,753	November 2004 6-week duration
	Evaluate roads project in Cape Verde.	\$100,000	February 2006 5- to 6-week duration
U.S. Census Bureau	Assess monitoring and evaluation methodologies proposed by eligible countries and assist eligible countries in implementing the methodologies.	\$750,000 <sup>b</sup>	March 2005 3-year duration
U.S. Department of Agriculture's Foreign Agricultural Service	Assist in evaluating agricultural sector projects proposed by MCC-eligible countries.	\$1,000,000	March 2005 3-year duration

Source: GAO synthesis of MCC information as of April 2006.

<sup>a</sup>For fiscal year 2004 Threshold Program. All funds under this agreement must be obligated by September 30, 2005, unless MCC notifies USAID otherwise.

<sup>b</sup>Funding is for a 1-year period.

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**MCC Is Consulting with Other Donors and Using Donor Expertise**

MCC has received information and expertise from key multilateral and bilateral donors in the United States and eligible countries. For example, World Bank staff have briefed MCC regarding eligible countries, and officials from the Inter-American Development Bank said that they have provided MCC with infrastructure assessments in Honduras. According to MCC, most donor coordination is expected to occur in eligible countries rather than at the headquarters level. In some cases, MCC is directly coordinating its efforts with other donors through existing mechanisms, such as a G-17 donor group in Honduras.

In addition to soliciting donor input, MCC officials have encouraged donors not to displace assistance to countries that receive MCA funding.<sup>55</sup> Donors in Honduras told us that MCA funding to that country is unlikely to reduce their investment, because sectors included in the country's proposal have additional needs that would not be met by MCA.

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**MCC Has Met with NGOs**

According to MCC officials, MCC is holding monthly meetings with a U.S.-based NGO working group<sup>56</sup> and hosted five public meetings in 2004 in Washington, D.C., as part of its domestic outreach efforts. The NGOs have shared expertise in monitoring and evaluation and have offered suggestions that contributed to the modification of 1 of MCC's 16 quantitative indicators. In addition, MCC has met with local NGOs during country visits.

Some U.S.-based NGOs have raised questions about the involvement of NGOs in this country and of civil society groups in compact-eligible countries. Environmental NGOs told us in January 2005 that MCC had not engaged with them since initial outreach meetings; however, MCC subsequently invited NGOs and other interested entities to submit proposals for a quantitative indicator of a country's natural resources management. Representatives of several NGOs commented that MCC lacks in-house expertise and staff to monitor and assess civil society participation in compact development. In addition, U.S.-based NGOs expressed concern that their peers in MCA countries have not received

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<sup>55</sup>Previous GAO work on the Global Fund to fight AIDS, TB and Malaria indicates that it can be difficult to monitor donor spending on specific programs and to ensure that new grants augment spending at the country level (see GAO-03-601).

<sup>56</sup>The NGO Implementation Working Group on the Millennium Challenge Account includes InterAction, an alliance of more than 160 U.S.-based international development and humanitarian organizations.

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complete information about the proposal development process.

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**MCC Has Made Progress in Developing Management Structures but Has Not Completed Corporatewide Plans, Strategies, and Time Frames**

Since starting up operations, MCC has made progress in developing key administrative infrastructures that support its program implementation. MCC has also made progress in establishing corporatewide structures for accountability, governance, internal control, and human capital management, including establishing an audit and review capability through its IG, adopting bylaws, providing ethics training to employees, and expanding its permanent full-time staff. However, MCC has not yet completed plans, strategies, and time frames needed to establish these essential management structures on a corporatewide basis. (See fig. 8 for a detailed summary of MCC's progress.)

Figure 8: MCC's Progress on Key Management Structures

Key management structures	Actions completed	Actions under way or planned
<b>Administrative infrastructure</b> <i>Basic infrastructure needed to support program operations.</i>	<ul style="list-style-type: none"> <li>Acquired temporary offices</li> <li>Outsourced administrative aspects of accounting and human resource functions to Department of the Interior's National Business Center</li> <li>Hired initial staff</li> <li>Developed and implemented computer network</li> </ul>	<ul style="list-style-type: none"> <li>Move to new location in Washington, D.C. (May 2005)</li> <li>Develop records management policy</li> </ul>
<b>Accountability</b> <i>Effectively demonstrating to both internal and external parties (e.g., Congress, public) that resources are managed properly, programs are achieving intended goals and outcomes, and programs are provided efficiently and effectively.</i>	<ul style="list-style-type: none"> <li>Issued statements of mission and goals in various documents; began strategic planning</li> <li>Completed initial audits of MCC's financial statements and related internal control, ethics program, and efforts to achieve intended organizational structure, under the direction of MCC's statutorily-designated IG</li> <li>Issued consolidated report to satisfy annual reporting requirements of Millennium Challenge Act and Government Corporation Control Act</li> </ul>	<ul style="list-style-type: none"> <li>Complete strategic planning process; issue strategic plan</li> <li>Issue annual performance plan (required under the Government Performance and Results Act)<sup>6</sup></li> <li>Conduct several follow-on IG audits (e.g., financial statements, ethics, internal control, achieving organizational structure)</li> <li>Complete development of methodology for monitoring and evaluating compacts, including metrics that will be incorporated into compacts and used to evaluate a country's progress</li> </ul>
<b>Corporate governance</b> <i>Collective policies and mechanisms used by the Board to effectively oversee management efforts to establish and maintain a sustainable and accountable organization.</i>	<ul style="list-style-type: none"> <li>MCC Board</li> <li>Adopted bylaws</li> <li>Approved selection criteria and methodology for eligible countries</li> <li>Selected initial round of countries eligible to enter into compacts</li> <li>Approved MCC officers</li> <li>Board established a compensation committee in March 2005, and a charter for the committee is being drafted</li> <li>MCC is drafting a policy related to the board's corporate governance</li> </ul>	<ul style="list-style-type: none"> <li>Develop an approved board policy on corporate governance</li> </ul>
<b>Internal control</b> <i>Integral component of organization management that provides reasonable assurance that key objectives—efficiency and effectiveness of operations, reliability of financial reporting, and compliance with applicable laws and regulations—are being achieved.</i>	<ul style="list-style-type: none"> <li>Adopted accounting principles</li> <li>Documented the compact development process (including role and composition of Investment Committee)</li> <li>Performed due diligence reviews of proposed compact programs</li> <li>Established Ethics Program and conducted related training</li> <li>Established Investment Committee to oversee compact development process</li> <li>Established procedures detailing actions that require legal review and clearance</li> <li>MCC established an internal controls strategy group to formalize the assessment of the corporation's internal control environment, identify risks, assign priorities and responsibility, and establish time frames</li> <li>Implemented various policies (e.g., government vehicle use, security, use of information technology resources)</li> <li>Using federal travel regulation and federal acquisition regulation</li> <li>Developed policies for work hours/overtime and leave</li> <li>Established interagency legal working group (held meets with board agency attorneys to discuss pending international legal issues)</li> </ul>	<ul style="list-style-type: none"> <li>Complete development of additional management tools (e.g., compact development pipeline) to assist staff, management, and MCC board in monitoring the compact development process</li> <li>Provide Contracting Officer Technical Representative (COTR) training</li> <li>Develop financial management policies and procedures</li> <li>Supplement federal travel and acquisition regulations with policies applicable to MCC</li> <li>Work with IG to develop compact audit provision</li> </ul>
<b>Human capital management</b> <i>Leadership, strategic human capital planning, developing and retaining talent, and a results-oriented culture are the cornerstones of strategic human capital management.</i>	<ul style="list-style-type: none"> <li>Established organizational structure</li> <li>Obtained Schedule A hiring authority from the Office of Personnel Management (OPM)</li> <li>Planned initial staffing projections</li> <li>Contracted with international recruiting firm to expand hiring efforts</li> <li>Contracted with human capital consultant</li> </ul>	<ul style="list-style-type: none"> <li>Develop strategic human capital plans</li> <li>Continue recruitment</li> <li>Issue competitive hiring plans and procedures by March 31, 2006 (required by CPM)</li> <li>Complete compensation study by summer 2005</li> <li>Adopt employee Performance Management Program</li> </ul>

Source: GAO. Items under "Actions completed" and "Actions under way or planned" represent GAO's synthesis of MCC information.

<sup>6</sup>Schedule A refers to positions specifically exempted from federal competitive service requirements.

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<sup>a</sup>According to MCC officials, MCC and OMB have agreed that MCC may submit a modified report to satisfy the Government Performance and Results Act requirement of a performance plan and report by March 31, 2005. MCC expects to submit the report by the end of fiscal year 2005.

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**Administrative Infrastructure** During its first 15 months, MCC management focused its efforts on establishing essential administrative infrastructures—the basic systems and resources needed to set up and support its operations—which also contribute to developing a culture of accountability and control. In February 2004, MCC acquired temporary offices in Arlington, Virginia, and began working to acquire a permanent location. In addition, consistent with its goal of a lean corporate structure with a limited number of full-time employees, MCC outsourced administrative aspects of its accounting, information technology, travel, and human resource functions. Further, MCC implemented various other administrative policies and procedures to provide operating guidance to staff and enhance MCC’s internal control. MCC management continues to develop other corporate policies and procedures, including policies that will supplement federal travel and acquisition regulations.

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**Accountability** Accountability requires that a government organization effectively demonstrate, internally and externally, that its resources are managed properly and used in compliance with laws and regulations and that its programs are achieving their intended goals and outcomes and are being provided efficiently and effectively. Important for organizational accountability are effective strategic and performance planning and reporting processes that establish, measure, and report an organization’s progress in fulfilling its mission and meeting its goals. External oversight and audit processes provide another key element of accountability.

During its initial 15 months, MCC developed and communicated to the public its mission, the basic tenets of its corporate vision, and key program-related decisions by the MCC board. MCC began its strategic planning process when key staff met in January 2005 to begin setting strategic objectives and it expects to issue the completed plan in the coming months. In addition, MCC arranged with its IG for the audit of its initial year financial statements (completed by an independent public accounting firm) and for two program-related IG reviews. However, to date, MCC has not completed a strategic plan or established specific implementation time frames. In addition, MCC has not yet established annual performance plans, which would facilitate its monitoring of progress toward strategic and annual performance goals and outcomes and its reporting on such progress internally and externally. According to MCC officials, MCC intends to complete its comprehensive strategic and performance plans by the end of fiscal year 2005.

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Corporate Governance	<p>Corporate governance can be viewed as the formation and execution of collective policies and oversight mechanisms to establish and maintain a sustainable and accountable organization while achieving its mission and demonstrating stewardship over its resources. Generally, an organization's board of directors has a key role in corporate governance through its oversight of executive management, corporate strategies, risk management and audit and assurance processes, and communications with corporate stakeholders.</p> <p>During its initial 15 months, the MCC board adopted bylaws regarding board composition and powers, meetings, voting, fiscal oversight, and the duties and responsibilities of corporate officers and oversaw management's efforts to design and implement the compact program. According to MCC, during a recent meeting of the board to discuss corporate governance, the Chief Executive Officer solicited feedback from the board regarding defining and improving the governance process. MCC's board established a compensation committee in March 2005, and a charter for the committee is being drafted. In addition, MCC is preparing, for board consideration, a policy on the board's corporate governance. As drafted, the policy identifies the board's statutory and other responsibilities, elements of board governance, rules and procedures for board decision-making, and guidelines for MCC's communications with the board. With regard to MCC board membership, seven of the nine board members have been appointed and installed. Through board agency staff, MCC staff have regularly informed board members—four of whom are heads of other agencies or departments—about pending MCC matters.</p> <p>The board has not completed a comprehensive strategy or plan for carrying out its responsibility—specifically, it has not defined the board's and management's respective roles in formulating and executing of corporate strategies, developing risk management and audit and assurance processes, and communicating and coordinating with corporate stakeholders. Moreover, although the bylaws permit the board to establish an audit committee—to support the board in accounting and financial reporting matters; determine the adequacy of MCC's administrative and financial controls; and direct the corporation's audit function, which is provided by the IG and its external auditor—the board has not yet done so. Finally, two of the MCC board's four other positions have not yet been filled.</p>
Internal Control	<p>Internal control provides reasonable assurance that key management objectives—efficiency and effectiveness of operations, reliability of financial reporting, and compliance with applicable laws and regulations—are being achieved. Generally, a corporatewide internal control strategy is designed to</p>



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- create and maintain an environment that sets a positive and supportive attitude toward internal control and conscientious management;
  - assess, on an ongoing basis, the risks facing the corporation and its programs from both external and internal sources;
  - implement efficient control activities and procedures intended to effectively manage and mitigate areas of significant risk;
  - monitor and test control activities and procedures on an ongoing basis; and
  - assess the operating effectiveness of internal control and report and address any weaknesses.

During its first 15 months, MCC took several actions that contributed to establishing effective internal control. Although it did not conduct its own assessment of internal control, MCC management relied on the results of the IG reviews and external financial audit to support its conclusion that key internal controls were valid and reliable. Further, MCC implemented processes for identifying eligible countries and internal controls through its due diligence reviews of proposed compacts, establishment of the Investment Committee to assist MCC staff in negotiating and reviewing compact proposals, and the board's involvement in approving negotiated compacts. In addition, MCC instituted an Ethics Program, covering employees as well as outside board members, to provide initial ethics orientation training for new hires and regularly scheduled briefings for employees on standards of conduct and statutory rules. In April 2005, MCC officials informed us that they had recently established an internal controls strategy group to identify internal control activities to be implemented over the next year, reflecting their awareness of the need to focus MCC's efforts on the highest-risk areas.

However, MCC has not completed a comprehensive strategy and related time frames for ensuring the proper design and incorporation of internal control into MCC's corporatwide program and administrative operations. For example, MCC intends to rely on contractors for a number of operational and administrative services; however, this strategy will require special consideration in its design and implementation of specific internal controls.

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Human Capital Management	Cornerstones of human capital management include leadership; strategic human capital planning; acquiring, developing, and retaining talent; and building a results-oriented culture. In its initial year, MCC human capital efforts focused primarily on establishing an organizational structure and recruiting employees
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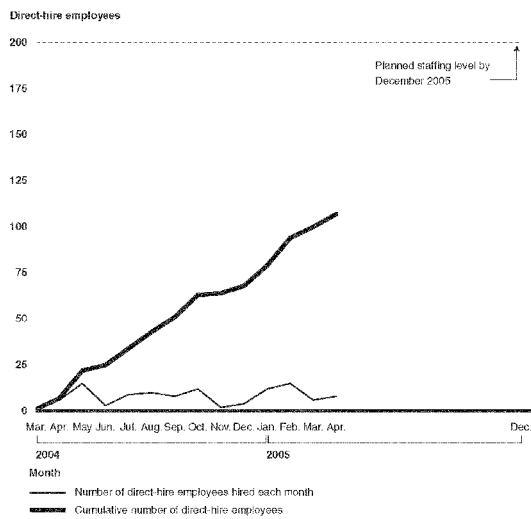
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necessary to support program design and implementation and corporate administrative operations (see app. VIII for a diagram of MCC's organizational structure). MCC set short- and longer-term hiring targets, including assigning about 20 employees—depending on the number and types of compacts that have been signed—to work in MCA compact-eligible countries; it also identified needed positions and future staffing levels through December 2005 based on its initial operations. With the help of an international recruiting firm, MCC expanded its permanent full-time staff from 7 staff employees in April 2004 to 107 employees in April 2005; it intends to employ no more than 200 permanent full-time employees by December 2005 (see fig. 9).<sup>37</sup> In addition, MCC hired 15 individuals on detail, under personal services contracts, or as temporary hires, as well as a number of consultants. Finally, in January 2005, MCC hired a consultant to design a compensation program to provide employees with pay and performance incentives and competitive benefits, including performance awards and bonuses, retention incentives, and student loan repayments. MCC officials told us that they intend the program to be comparable with those of federal financial agencies, international financial institutions, and multilateral and private sector organizations.

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<sup>37</sup>Fifteen of these positions are administratively determined; Congress authorized 30 such positions for MCC in the Millennium Challenge Act.

**Figure 9: Actual and Planned Staffing Levels as of April 1, 2005**



Source: GAO analysis of unaudited MCC data as of April 2005.

MCC has not completed an institutional infrastructure that includes (1) a thorough and systematic assessment of the staffing requirements and critical skills needed to carry out its mission; (2) a human capital planning process that integrates MCC's human capital policies and strategies with its program goals and mission; and (3) a performance management system that links employees' pay and incentive programs to individual knowledge, skills, performance, and contributions. MCC officials acknowledged the need to refine and systematize MCC's workforce planning to ensure that the corporation has the human capital capability needed for a broad range of programs in a number of developing nations.

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## Conclusions

In its first 15 months, MCC took important actions to design and implement the compact program—making eligibility determinations, defining its compact development process, and coordinating and establishing working agreements with key stakeholders. MCC also acted to establish important elements of a corporatewide management structure needed to support its mission and operations, including some key internal controls. However, MCC has not yet fully developed plans that define the comprehensive actions needed to establish key components of an effective management structure.

We believe that, to continue to grow into a viable and sustainable entity, MCC needs to approve plans with related time frames that identify the actions required to build a corporatewide foundation for accountability, internal control, and human capital management and begin implementing these plans. In addition, MCC's board needs to define its responsibilities for corporate governance and oversight of MCC and develop plans or strategies for carrying them out. As MCC moves into its second year of operations, it recognizes the need to develop comprehensive plans and strategies in each of these areas. Implementation of such plans and strategies should enable MCC's management and board to measure progress in achieving corporate goals and objectives and demonstrate its accountability and control to Congress and the public. As part of our ongoing work for your committee, we will continue to monitor MCC's efforts in these areas.

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## Recommendations for Executive Action

We recommend that the Chief Executive Officer of the Millennium Challenge Corporation complete the development and implementation of overall plans and related time frames for actions needed to establish

1. Corporatewide accountability, including
  - implementing a strategic plan,
  - establishing annual performance plans and goals,
  - using performance measures to monitor progress in meeting both strategic and annual performance goals, and
  - reporting internally and externally on its progress in meeting its strategic and annual performance goals.
2. Effective internal control over MCC's program and administrative operations, including establishing

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- a positive and supportive internal control environment;
  - a process for ongoing risk assessment;
  - control activities and procedures for reducing risk, such as measures to mitigate risk associated with contracted operational and administrative services;
  - ongoing monitoring and periodic testing of control activities; and
  - a process for assessing and reporting on the effectiveness of internal controls and addressing any weaknesses identified.
3. An effective human capital infrastructure, including
- a thorough and systematic assessment of the staffing requirements and critical skills needed to carry out MCC's mission;
  - a plan to acquire, develop, and retain talent that is aligned with the corporation's strategic goals; and
  - a performance management system linking compensation to employee contributions toward the achievement of MCC's mission and goals.

We recommend that the Secretary of State, in her capacity as Chair of the MCC Board of Directors, ensure that the board considers and defines the scope of its responsibilities with respect to corporate governance and oversight of MCC and develop an overall plan or strategy, with related time frames, for carrying out these responsibilities. In doing so, the board should consider, in addition to its statutory responsibilities, other corporate governance and oversight responsibilities commonly associated with sound and effective corporate governance practices, including oversight of

- executive management,
- the formulation and execution of corporate strategies,
- risk management and audit and assurance processes, and
- communication and coordination with corporate stakeholders.

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**Agency Comments and  
Our Evaluation**

MCC provided technical comments on a draft of this statement and agreed to take our recommendations under consideration; we addressed MCC's comments in the text as appropriate. We also provided the Departments of State and Treasury, the U.S. Agency for International Development, and the Office of the U.S. Trade Representative an opportunity to review a draft of this statement for technical accuracy. State and USAID suggested no changes, and Treasury and USTR provided a few technical comments, which we incorporated as appropriate.

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Mr. Chairman and Members of the Committee, this concludes my prepared statement. I will be happy to answer any questions you may have.

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**Contacts and  
Acknowledgments**

For questions regarding this testimony, please call David Gootnick at (202) 512-4128 or Phillip Herr at (202) 512-8509.

Other key contributors to this statement were Todd M. Anderson, Beverly Bendekgey, David Dornisch, Etana Finkler, Eric Jackson, Debra Johnson, Joy Labez, Reid Lowe, David Merrill, John Reilly, Michael Rohrbach, Mona Sehgal, and R.G. Steinman.

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## Appendix I: Scope and Methodology

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We reviewed MCC's activities in its first 15 months of operations, specifically its (1) process for determining country eligibility for fiscal years 2004 and 2005, (2) progress in developing compacts, (3) coordination with key stakeholders, and (4) establishment of management structures and accountability mechanisms.

To examine MCC's country selection process, we analyzed candidate countries' scores for the 16 quantitative indicators for fiscal years 2004 and 2005, as well as the selection criteria for the fiscal year 2004 Threshold Program. We used these data to determine the characteristics of countries that met and did not meet the indicator criteria and to assess the extent to which MCC relied on country scores for eligibility determination. We also reviewed the source data for the indicator scores posted on MCC's Web site to identify issues related to public access and to determine whether we could reproduce the country scores from the source data. Our review of the source data methodology, as well as the documents of other experts, allowed us to identify some limitations of the indicator criteria used in the country selection process. For these and other data we used in our analyses, we examined, as appropriate, the reliability of the data through interviews with MCC officials responsible for the data, document reviews, and reviews of data collection and methodology made available by the authors. We determined the data to be reliable for the purposes of this study.

To describe MCC's process for developing compacts, including plans for monitoring and evaluation, we reviewed MCC's draft or finalized documents outlining compact proposal guidance, compact proposal assessment, and fiscal accountability elements. We reviewed eligible countries' compact proposals and concept papers to identify proposed projects, funding, and institutional frameworks, among other things. To summarize the projects that countries have proposed and that MCC is currently assessing, we developed categories and conducted an analysis of countries' proposal documents and MCC's internal summaries. We also reviewed Madagascar's draft compact to identify projects, funding, and framework for program implementation and fiscal accountability. We met with MCC officials to obtain updates on the compact development process. In addition, we interviewed representatives of nongovernmental organizations (NGOs) in Washington, D.C., and Honduras, as well as country officials in Honduras, to obtain their perspectives on MCC's compact development process.

To assess MCC's coordination with key stakeholders, we reviewed interagency agreements to identify the types of formal assistance that MCC is seeking from U.S. agencies and the funding that MCC has set aside for this purpose. We also reviewed MCC documents to identify the organizations, including other donors, with which MCC has consulted. In addition, we interviewed MCC officials regarding their coordination with various stakeholders. We met with officials

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from the U.S. agencies on the MCC board (Departments of State and Treasury, USAID, and USTR) to assess the types of assistance that these agencies have provided to MCC. We also contacted six USAID missions in compact-eligible countries to obtain information on MCC coordination with U.S. agencies in the field. To assess MCC's coordination with NGOs and other donors, we met with several NGOs, including InterAction, the World Wildlife Fund, and the Women's Edge Coalition in Washington, D.C., and local NGOs in Honduras; we also met with officials from the Inter-American Development Bank in Washington, D.C., and Honduras, as well as officials from the World Bank, Central American Bank for Economic Integration, and several bilateral donors in Honduras. Finally, we attended several MCC public outreach meetings in Washington, D.C.

To analyze MCC's progress in establishing management structures and accountability mechanisms, we interviewed MCC senior management and reviewed available documents to identify the management and accountability plans that MCC had developed or was planning to develop. We reviewed audit reports by the USAID Office of the Inspector General to avoid duplication of efforts. We used relevant GAO reports and widely used standards and best practices, as applicable, to determine criteria for assessing MCC's progress on management issues as well as to suggest best practices to MCC in relevant areas. Although our analysis included gaining an understanding of MCC's actions related to establishing internal control, we did not evaluate the design and operating effectiveness of internal control at MCC.

In January 2005, we conducted fieldwork in Honduras, one of four countries with which MCC had entered into negotiations at that time, to assess MCC's procedures for conducting compact proposal due diligence and its coordination with U.S. agencies, local NGOs, Honduran government officials, and other donors. In conducting our field work, we met with U.S. mission officials, Honduran government officials, donor representatives, and local NGOs. We also visited some existing USAID projects in the agricultural sector that were similar to projects that Honduras proposed.

We provided a draft of this statement to MCC, and we have incorporated technical comments where appropriate. We also provided a draft of this statement to the Departments of State and Treasury, USAID, and USTR; State and USAID suggested no changes, and Treasury and USTR provided technical comments, which we addressed as appropriate. We conducted our work between April 2004 and April 2005, in accordance with generally accepted government auditing standards.



## Appendix II: Candidate and Eligible Countries for MCA and Threshold Programs, Fiscal Years 2004-2005

Candidate countries	MCC compact-eligible countries		Threshold Program countries		Candidate countries (continued)	MCC compact-eligible countries		Threshold Program countries	
	2004	2005	2004	2005		2004	2005	2004	2005
Afghanistan			*Albania		Lesotho	Lesotho	Lesotho		
*Albania					Madagascar	Madagascar	Madagascar		
Angola					Malawi			Malawi	
Armenia	Armenia	Armenia			Mali	Mali	Mali		
Azerbaijan					Mauritania				
Bangladesh					Moldova				
Benin	Benin	Benin			Mongolia	Mongolia	Mongolia		
Bhutan					Morocco	Morocco	Morocco		
Bolivia	Bolivia	Bolivia			Mozambique	Mozambique	Mozambique		
*Bosnia and Herzegovina					Nepal				
Burkina Faso			Burkina Faso		Nicaragua	Nicaragua	Nicaragua		
Cameroon					Niger				
*Cape Verde	*Cape Verde				Nigeria				
Chad					Pakistan				
China					Papua New Guinea				
Comoros					Paraguay			Paraguay	
Congo Democratic Republic					Philippines			Philippines	
Congo, Rep.					Rwanda				
Djibouti					São Tomé and Príncipe			São Tomé and Príncipe	São Tomé and Príncipe
East Timor			East Timor	East Timor	Senegal	Senegal	Senegal		
Egypt, Arab Rep. of					Sierra Leone				
Eritrea					Solomon Islands				
Ethiopia					Sri Lanka	Sri Lanka	Sri Lanka		
Gambia					Syria				
Georgia	Georgia	Georgia			Tajikistan				
Ghana	Ghana	Ghana			Tanzania			Tanzania	Tanzania
Guinea					Togo				
Guinea-Bissau**					*Tonga				
Guyana			Guyana		Turkmenistan				
Haiti					Uganda			Uganda	Uganda
Honduras	Honduras	Honduras			Ukraine				
India					Vanuatu	Vanuatu	Vanuatu		
Indonesia					Vietnam				
Kenya			Kenya	Kenya	Yemen Republic			Yemen Republic	Yemen Republic
Kiribati					Zambia				Zambia
Kyrgyz Republic									
Lao PDR									

\* Candidate for FY 2004 only.  
\*\* Prohibited under Foreign Assistance Act in FY 2004 but not in FY 2005.  
Candidate for FY 2005 only.

Source: GAO analysis and synthesis of MCC data.

Note: The countries listed do not include the 12 and 14 countries that were not candidates because of legal prohibitions in fiscal years 2004 and 2005, respectively.

## Appendix III: Indicators Used in the Selection Process

Table 1 lists each of the indicators used in the MCA compact and threshold country selection process, along with its source and a brief description of the indicator and the methodology on which it is based.

RULING JUSTLY		
Indicator/Source	Description	Methodology
<b>Political rights</b> Freedom House, Freedom in the World 2003	Measures the ability of citizens to participate freely in the political process. This includes the right to vote, elect representatives who have real power, and compete for public office.	A survey providing an annual evaluation of the state of global freedom. A panel of experts uses a broad range of sources of information, including foreign and domestic news reports, nongovernmental organization publications, think tank and academic analyses, individual professional contacts, and visits to the region. The panel rates countries on the prevalence of free and fair elections of officials with real power; the ability of citizens to form political parties that may compete fairly in elections; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies, and economic oligarchies; and the political rights of minority groups. Countries receive numerical ratings from 1 to 7, with 1 being the most free.
<b>Civil liberties</b> Freedom House, Freedom in the World 2003	Measures citizen's freedom to develop opinions, institutions, and personal autonomy without interference from the state.	
<b>Voice and accountability</b> Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003	Measures the ability of institutions to protect civil liberties, the extent to which citizens of a country are able to participate in the selection of governments, and the independence of the media.	An index of surveys based on several hundred individual variables measuring perceptions of governance, drawn from 25 separate data sources constructed by 18 different organizations. The governance indicators are measured in units ranging from –2.5 to 2.5, with higher values corresponding to better governance outcomes.
<b>Government effectiveness</b> Governance Matters III: Governance Indicators for 1996–2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003	Measures the ability of the government to formulate and implement sound policies, including quality of public service provision, quality of bureaucracy, competency of civil servants, independence of civil service from political pressures, credibility of the government's commitment to policies.	

<p><b>Rule of law</b> Governance Matters III: Governance Indicators for 1996-2002. D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003</p>	<p>Measures the extent to which the public has confidence in, and abides by, rules of society. Includes perception of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.</p>	
<p><b>Control of corruption</b> Governance Matters III: Governance Indicators for 1996-2002. D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003</p>	<p>Rates countries on the frequency of "additional payments to get things done," the effects of corruption on the business environment, "grand corruption" in the political arena, and the tendency of elites to engage in "state capture."</p>	

**INVESTING IN PEOPLE**

<b>Indicator/Source</b>	<b>Description</b>	<b>Methodology</b>
<p><b>Primary (girls') education completion rate</b> World Bank (EdStats and Education for All, World Development Indicators) and UNESCO Institute for Statistics, various years</p>	<p>The number of students (girls) completing primary education, divided by the population in the relevant age cohort.</p>	<p>EdStats compiles data from a variety of sources. The primary sources are the UNESCO Institute for Statistics (UIS), the Organization for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the World Bank and its client countries.</p>
<p><b>Primary education spending (% OF GDP)</b> National Governments and World Bank (Education For All), various years</p>	<p>Total expenditures on primary education by government at all levels, divided by GDP.</p>	<p>Data from national sources was gathered directly from the governments of both the candidate countries and the legally prohibited countries in March and April 2004 with the assistance of U.S. embassies.</p>
<p><b>Public health spending (% OF GDP)</b> National Governments, supplemented by World Bank (World Development Indicators), various years</p>	<p>Total expenditures on health by government at all levels, divided by GDP.</p>	<p>Same methodology as Primary education spending (% of GDP).</p>
<p><b>Diphtheria and measles immunization rate</b> World Health Organization and UNICEF estimates of National Immunization Coverage, 2002</p>	<p>The average of DPT3 and measles immunization rates for the most recent year available.</p>	<p>Data officially reported to WHO and UNICEF by Member States in addition to data reported in the published and grey literature. WHO and UNICEF also consult with local experts - primarily national EPI managers and WHO regional office staff - for additional information regarding the performance of specific local immunization services. The true level of immunization is based on estimates of national immunization for various vaccines.</p>

ECONOMIC FREEDOM		
Indicator/Source	Description	Methodology
<b>Country credit rating</b> <i>Institutional Investor</i> , March 2004	A semi-annual survey of bankers' and fund managers' perceptions of a country's risk of default	<i>Institutional Investor</i> reports regularly and provides credit ratings, based on the perceived risk of government default, every 6 months for 145 countries, including 85 MCA countries. Countries are ranked on a scale from 1 to 100 based on information provided by economists and sovereign risk analysts from banks and money management and securities firms.
<b>Fiscal policy</b> IMF World Economic Outlook, 2003 or more recent data, if available	Overall budget deficit (after receipt of grants but not concessional loans; includes interest on debt) divided by GDP, averaged over a 3-year period	The IMF provided the MCC with the budget deficit data, which is otherwise not publicly available. We do not know what methodology the IMF used to obtain this data for all countries. However, WEO short-term fiscal policy assumptions for advanced economies are based on officially announced budgets adjusted for differences between the national authorities and the IMF staff regarding macroeconomic assumptions and projected fiscal outcomes.
<b>Trade policy</b> Heritage Foundation/Wall Street Journal 2004 Index of Economic Freedom	A country's openness to international trade based on average tariff rates and nontariff barriers to trade, on a scale of 1 to 5, with 1 being the most open.	This is a subjective indicator. The countries are rated from 1 to 5, based primarily on tariff and quota rates, where available.
<b>Regulatory quality</b> Governance Matters III: Governance Indicators for 1996-2002, D. Kaufmann, A. Kraay, and M. Mastruzzi, The World Bank, 2003	Measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, as well as perception of the burdens imposed by excessive regulation in areas such as foreign trade and business development.	Same methodology as voice and accountability, above.
<b>Days to start a business</b> May 2004, World Bank <i>Doing Business</i>	The number of days required for companies to complete all procedures necessary to legally start a business.	<i>Doing Business</i> compiles a comprehensive list of entry regulations by recording all the procedures that are officially required for an entrepreneur to obtain all necessary permits, and to notify and file with all requisite authorities, in order to legally operate a business. The data are from January 2003.

<p><b>One-year consumer price inflation</b>          IMF <i>International Financial Statistics</i> (2002, 2003), supplemented by national government data, and IMF's <i>World Economic Outlook</i>, various years</p>	<p>The most recent 12-month change in consumer prices as reported in the IMF's <i>International Financial Statistics</i> or in another public forum by the relevant national monetary authorities.</p>	<p>Consumer price indexes (CPI) are used most frequently as an indicator of inflation. The CPI reflect changes in the cost of acquiring a fixed basket of goods and services by the average consumer. Weights are derived from household expenditure surveys, which may be conducted infrequently.</p>
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Since announcing the 16 quantitative indicators that it used to determine country eligibility for fiscal year 2004, MCC made two changes for fiscal year 2005 and is exploring further changes for fiscal year 2006. To better capture the gender concerns specified in the Millennium Challenge Act, MCC substituted "girls' primary education completion rate" for "primary education completion rate." It also lowered the ceiling for the inflation rate indicator from 20 to 15 percent. In addition, to satisfy the act's stipulation that MCC use objective and quantifiable indicators to evaluate a country's commitment to economic policies that promote sustainable natural resource management, MCC held a public session on February 28, 2005, to launch the process of identifying such an indicator. MCC expects to complete the process by May 2005.

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## Appendix IV: Threshold Program Selection Process

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The MCC board used objective criteria (a rules-based methodology) and exercised discretion to select the threshold countries (see fig. 10). For fiscal year 2004, the MCC board relied on objective criteria in selecting as Threshold Program candidates countries that needed to improve in 2 or fewer of the 16 quantitative indicators used to determine MCA eligibility. (That is, by improving in two or fewer indicators, the country would score above the median on half of the indicators in each policy category, would score above the median on the corruption indicator, and would not score substantially below the median on any indicator.) MCC identified 15 countries that met its stated criteria and selected 7 countries to apply for Threshold Program assistance. Our analysis suggests that one of these seven countries did not meet MCC's stated Threshold Program criteria.<sup>1</sup> The MCC board also exercised discretion in assessing whether countries that passed this screen also demonstrated a commitment to undertake policy reforms to improve in deficient indicators.

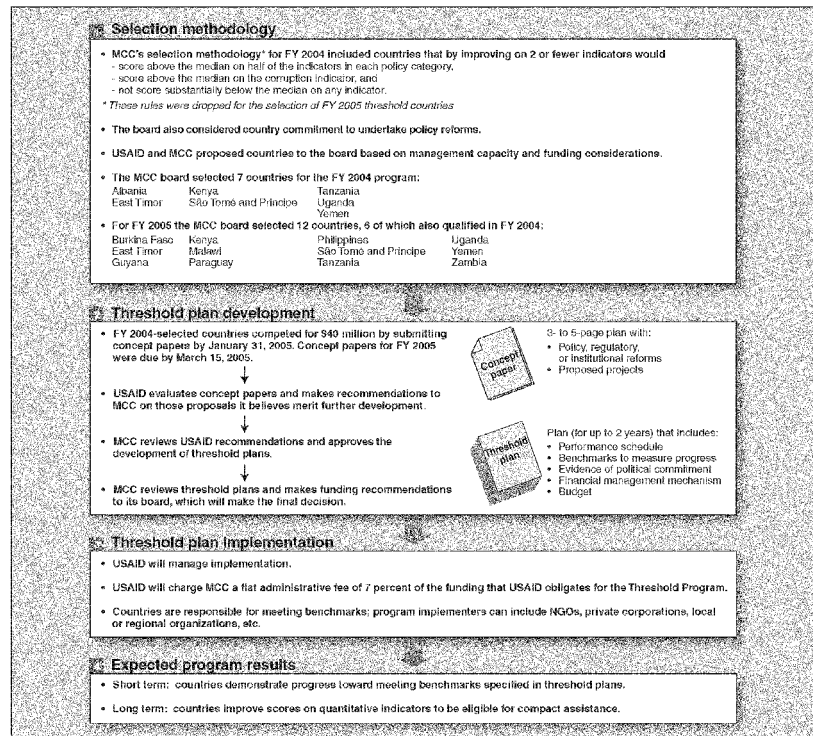
For fiscal year 2005, the MCC did not employ a rules-based methodology for selecting Threshold Program candidates. Instead, the board selected Threshold Program and MCA compact-eligible countries simultaneously. The board selected 12 countries to apply for Threshold Program assistance, including reconfirming the selection of 6 countries<sup>2</sup> that also had qualified for the fiscal year 2004 Threshold Program.

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<sup>1</sup>Yemen would have had to improve on at least three indicators to meet the fiscal year 2004 Threshold Program criteria.

<sup>2</sup>Albania was not a candidate for fiscal year 2005 due to per capita income above the IDA ceiling.

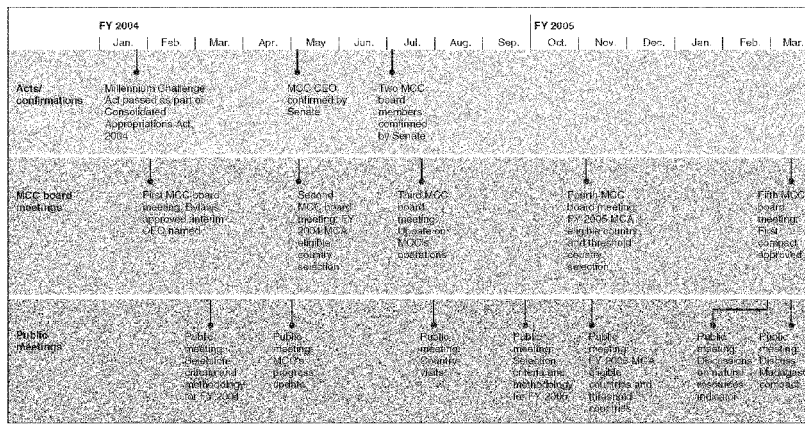
Figure 10: MCC's Threshold Program



## Appendix V: Timeline of Key Events

Figure 11 illustrates key events and defining actions relating to MCC since the passage of the Millennium Challenge Act in January 2004.

Figure 11: Timeline of Key MCC-related Events and Actions, Fiscal Years 2004-2005



Source: GAO synthesis of MCA information through March 2005.



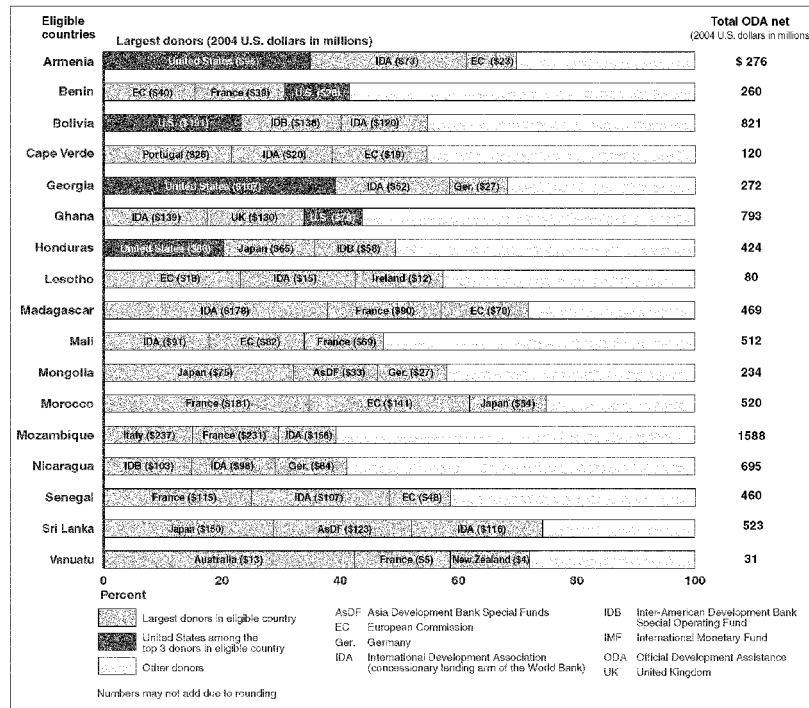
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## Appendix VI: Donors in MCA Compact-eligible Countries

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MCC plans to be among the top donors in MCA compact-eligible countries. Figure 12 shows the total official development assistance net (average for 2002 and 2003) provided by the top three donors as well as the amount of total official development assistance net (average for 2002 and 2003) provided by all donors in each of the MCA compact-eligible countries. As the figure indicates, based on the average for the years 2002-2003, the United States was the top donor in Armenia, Bolivia, Georgia, and Honduras and was among the top five donors in nine additional countries.

Figure 12: Top Donors in MCA Compact-eligible Countries, Total Annual ODA Net, Average for 2002 – 2003



## Appendix VII: MCC Coordination with Key Stakeholders

MCC is coordinating its program and funding activities with various stakeholders to keep them informed and to utilize their expertise or resources at headquarters and in the field (see fig. 13). In addition, several U.S. agencies have taken steps to coordinate their activities with MCC.

Figure 13: MCC Coordination with Key Stakeholders

	Coordination mechanisms	Examples of coordination
<b>U.S. agencies</b>	<ul style="list-style-type: none"> <li>• USAID established an MCC coordination unit with three staff</li> <li>• State has assigned an MCA coordinator</li> <li>• Treasury and USTR officials are providing advice or reviewing information as needed</li> <li>• MCC has signed agreements with                             <ul style="list-style-type: none"> <li>- USAID to design and implement Threshold Program</li> <li>- U.S. Army Corps of Engineers (USACE) to evaluate proposed infrastructure projects</li> <li>- Treasury's Office of Technical Assistance to assess and monitor fiscal accountability</li> <li>- U.S. Census Bureau to evaluate proposed monitoring and evaluation methodologies.</li> <li>- USDA to evaluate proposed agricultural sector projects.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• USAID and State facilitated MCC country visits</li> <li>• USAID provided country-specific information to MCC.</li> <li>• USAID formulated its 2003<sup>8</sup> regional strategy for Central America around MCC's three policy categories.</li> <li>• State provided supplemental information for country selection process.</li> <li>• Treasury has facilitated coordination with multilateral donors.</li> <li>• USTR has facilitated meetings with World Trade Organization ambassadors of eligible countries.</li> <li>• USDA has reviewed agricultural projects.</li> <li>• USACE is helping review infrastructure projects.</li> </ul>
<b>Donors</b>	<ul style="list-style-type: none"> <li>• MCC conducts direct outreach to and consultations with donors in headquarters and eligible countries</li> <li>• Existing donor coordination mechanism in eligible countries</li> </ul>	<ul style="list-style-type: none"> <li>• Eligible countries are using World Bank- and IMF-supported Poverty Reduction Strategy Papers to develop compact proposals.</li> <li>• IMF provided budget data for MCC's fiscal policy indicator.</li> <li>• Inter-American Development Bank (IDB) has provided studies and assessments.</li> <li>• World Bank and IDB officials have briefed MCC.</li> <li>• MCC has sought program-specific input from donors in eligible countries.</li> </ul>
<b>NGOs</b>	<ul style="list-style-type: none"> <li>• Public meetings</li> <li>• NGO-specific meetings</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. NGOs have helped MCC identify country-based NGOs</li> <li>• NGOs have shared monitoring and evaluation expertise</li> <li>• NGOs provided input to make an <i>Investing in People</i> indicator gender sensitive</li> </ul>

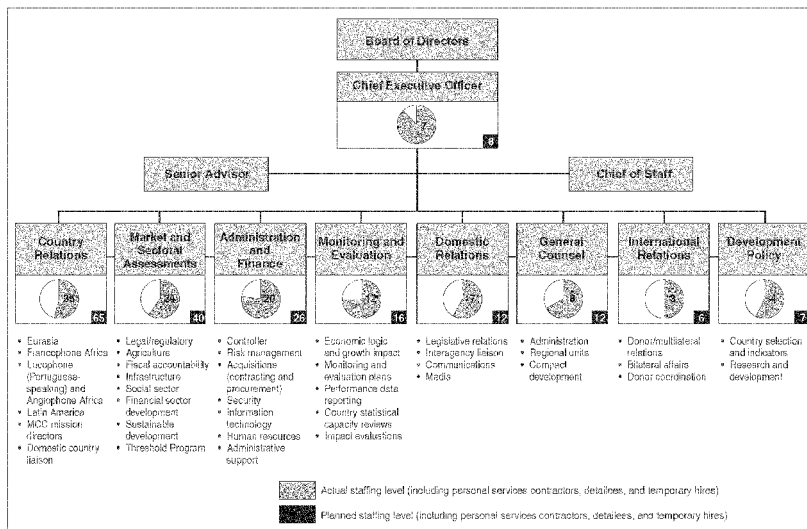
Source: GAO synthesis of information provided by MCC.

<sup>8</sup>Although MCC was formally established in February 2004, an interagency team that included representatives from the National Security Council, State, USAID, Treasury, and the Office of Management and Budget began designing and implementing the MCA initiative in the spring of 2002.

## Appendix VIII: MCC Organizational Structure

Within each of the eight functional areas shown in figure 14, the actual staffing level as of April 2005 appears in the pie chart in each box and the planned staffing level by December 2005 appears in the right corner of each box.

Figure 14: MCC Organizational Structure As of April 1, 2005



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Chairman HYDE. Thank you, Dr. Gootnick.  
Mr. Walsh.

**STATEMENT OF MR. CONOR O. WALSH, COUNTRY  
REPRESENTATIVE—HONDURAS, CATHOLIC RELIEF SERVICES**

Mr. WALSH. Thank you very much, Chairman Hyde and Members of the Committee, for organizing this hearing on the Millennium Challenge Corporation and for inviting me to testify. It is an honor to have this opportunity.

As you stated during the introduction, my name is Conor Walsh, and I work for Catholic Relief Services as the country representative in Honduras. My remarks today will focus less on the economics and more on the social aspects of the MCC as it has been implemented in Honduras.

Because the success or the failure of the MCC initiative depends so much on local participation and on linking growth to poverty reduction, I will comment on the following two concerns: Number one, how much has civil society actually participated in the MCC Compact proposal process?; and, number two, will the proposed MCC activities result in economic growth that yields positive impacts for the poor?

Let me start off by saying that Catholic Relief Services is encouraged and shares the vision at the heart of the MCC. What stands out in the MCC philosophy more than any other is its principle of ensuring country ownership, and it is this aspect that distinguishes the program from many other development-assistance programs.

To its credit, the Government of Honduras, together with the MCC design team, has solicited feedback from various social sectors on the draft compact proposal. I, along with local business councils, government officials, and NGOs, have attended meetings with the MCC. Information on the proposal has been posted on the Web with an on-line comments option, and in response to the comments received, the original proposal has been scaled down, and its focus has tightened.

However, despite these commendable efforts in Honduras, our local partners, including the local church, have expressed doubts about the extent of citizen ownership. Local citizens' groups do not necessarily share the priorities that are set forth in the compact proposal. They do not feel that they were consulted sufficiently, and they have expressed reservations about the compact proposal in general. They also detected bias in the way the MCC team selected its audience, with a heavy predominance of private business, government, and government-aligned civil society groups.

The Honduran Government contends that the MCC proposal is based on the consultations underlying the poverty-reduction strategy paper, to which Dr. Gootnick just alluded, and that it, therefore, enjoys broad popular consensus. However, the PRSP process in Honduras was widely criticized by civil society groups; and, therefore, it should not so much serve as a model for effective citizens' participation but, rather, as a cautionary lesson of what can go wrong.

Mr. Applegarth noted this morning that there have been improvements, and I share those, and I am not going to go into those details, but the very principle that they have based the compact on,

the PRSP, is problematic. I do applaud the MCC design team for including at least some civil society representatives on the proposed governing council for the compact, but I do urge it to expand and strengthen the voice of local actors.

It is critical to understand why CRS emphasizes so strongly the importance of meaningful local participation in the MCC. If we have learned one thing over the past 60 years, it is that the most effective programs are those which are locally designed and implemented by the intended beneficiaries. Civil society has a vital role to play in assessing problems, prioritizing investments, and identifying practical approaches to carrying out projects.

In the time remaining, I would like to turn quickly to the second question that I asked at the outset: Will the proposed MCC activities actually result in economic growth that yields positive impacts for the poor? Our experience as a faith-based, development agency shows us that economic growth can have a powerful impact on poverty but only if the underlying inequities and imbalances that prevent the poor from sharing in the benefits of such growth are addressed. Our partners in Honduras have serious doubts that the proposed MCC activities will actually address those imbalances.

One of the major investments called for is roads infrastructure. The question is, who will be the primary beneficiaries of such road improvements? At this point, it is still unclear where the secondary and tertiary roads referred to earlier that connect farms to markets will actually be built. Unless the roads reach those parts of the country where the largest concentrations of poor farmers are to be found, the impact of road improvements on poverty reduction is questionable.

Then, on the technical assistance issue, technical assistance for farmers, my concern has to do with the issue of sustainability. The MCC proposal correctly recognizes that the right kind of technical assistance is a prerequisite for economic growth for farmers. In my experience, technical assistance, whether it is on improved farming practices, crop diversification, et cetera, is most likely to be applied and sustained when farmers are involved as active participants and not mere recipients of technical know-how.

The starting point should be community organization and institutional capacity building. This gives the practices that are being promoted a more solid social foundation. Instead of relying exclusively on specialized consultancy firms, the proposal should ensure that credible organizations with strong community links accompany farmers before, during, and after the provision of technical assistance.

Furthermore, the compact should also lay out a far clearer strategy for addressing the needs of women. Because women play such a pivotal role that is often recognized in the rural economy, agricultural technical assistance should be geared toward those activities on which women spend the most time. This might be related to processing, the sale of produce, or other activities.

Finally, on the issue of credit, it is vital for a successful rural development strategy to include access to rural credit for small farmers, but if it is extended primarily to more competitive farmers, the poor, more remote farmers are likely to lose out, and inequalities will increase further.



In conclusion, all of these activities may actually end up stimulating economic growth which may reach the poorer segments of society, but in order to make sure that they do, some simple steps should be followed. In other words, there is no need to start over. The weaknesses within the compact can be fixed. And, incidentally, I understand from my colleague country representatives in Madagascar and Nicaragua, two other MCC countries, that some of the similar concerns related to participation have also been raised.

In closing, I would respectfully like to submit the following recommendations: Number one, as Congress considers the reauthorization of MCC funding, it should refer to section 609[d], which calls for the local-level perspectives of the rural-urban poor, including women, to be taken into account.

Number two, the compact should address some of the technical shortcomings that were mentioned above by supporting proposals to implement social-audit mechanisms, which have worked so well in other contexts. In particular, in Honduras, local community organizations developed so-called “regional PRSPs” with extensive citizens’ participation, and these offer some valuable guidance on how to gather input that is broad based and reflective of local needs.

To finish, I want to thank the Committee for its support of innovative initiatives such as the MCC—the programs have great potential to reduce global poverty—and I also commend the Chairman and the Ranking Member for their stalwart support of non-governmental organizations such as Catholic Relief Services in Honduras.

[The prepared statement of Mr. Walsh follows:]

PREPARED STATEMENT OF MR. CONOR O. WALSH, COUNTRY REPRESENTATIVE—  
HONDURAS, CATHOLIC RELIEF SERVICES

Thank you, Chairman Hyde, and members of the House International Relations Committee, for organizing this hearing on the Millennium Challenge Corporation (MCC) and for inviting me to testify. I am honored to have this opportunity.

My name is Conor Walsh. I am the Honduras Country Representative for Catholic Relief Services, based in Tegucigalpa. Catholic Relief Services is the overseas relief and development agency of the US Catholic Church, and has been implementing projects in Honduras since 1959. Today it is one of the most active international non-governmental organizations (NGOs) operating there, in partnership with the Honduran Catholic Church and local groups. CRS/Honduras serves an estimated 300,000 people through programs in health, education, agriculture and the environment, emergency management, and strengthening civil society.

Having worked for CRS in Africa and Latin America for the past ten years, three and a half of which I spent in Honduras, I have come to appreciate the need for a new approach to US foreign assistance programs, given entrenched conditions of poverty and social injustice. My comments today will focus on two concerns that I have been able to observe as the MCC compact proposal from Honduras takes shape:

- 1) How much has civil society participated in the MCC compact proposal process?
- 2) Will the proposed MCC activities result in economic growth that yields tangible benefits for the poor?

Although Honduras has made progress in the past decades in consolidating a democratic form of government, it continues to fall short in meeting the basic needs of its population. Some of the constraints to achieving greater socioeconomic development are related to economic structures that favor traditional elites, be they agricultural landowners or owners of businesses. In addition, the country has grown dependent on large inflows of foreign assistance and on remittances sent by Honduran

émigrés working primarily in the United States. Honduras also has to deal with corruption, a problem on which successive governments have a mixed record.

To illustrate the problem of poverty in human terms, consider the following figures:

- over 50% of the population falls below the poverty threshold, but in rural areas this percentage increases to 70%
- Honduras has the highest HIV/AIDS infection rate of Central America (1.8%)
- Inequality is the most striking feature of Honduran poverty: The richest 20% of the population earns 59% of the national income, while the poorest 20% survive on less than 3%. Geographically, poverty is concentrated in the western departments bordering El Salvador, where the standard poverty measures such as the UNDP's Human Development Index are some 30% lower than the national averages. In terms of gender and women's participation in the political process, these areas also score significantly lower than the national average.<sup>1</sup>

In light of this situation, CRS was pleased to learn of the Administration's proposal to set up the Millennium Challenge Corporation, an initiative to tackle global poverty reduction through new and innovative means, and of Honduras' eligibility to present a compact proposal to the MCA. CRS shares the MCC's conviction that eligible governments should demonstrate their commitment to investing in people, promoting good governance, and economic freedoms. They must reinforce this commitment by ensuring broad participation of all citizens in decision-making on policy, implementing programs, and monitoring progress.

The cornerstone underlying the MCA's development approach—investing in activities that stimulate economic growth as a means of combating poverty—is also sound, as long as such growth reaches the poorest segments of society. Our experience as faith-based development workers shows us that economic growth can have a powerful impact on poverty, but only if growth impacts the underlying inequities and imbalances. The laudable MCA principle of ensuring country ownership distinguishes the program from many other development assistance programs. Country ownership assumes that the citizenry has been effectively engaged in the entire process of designing, negotiating, implementing, and monitoring programs. To be sustainable, “country ownership” should mean more than “government ownership.” It should also mean that the compact stems from an extensive consultation with civil society.

To its credit, the government of Honduras, together with the MCC, has solicited feedback and comments from various social sectors on the draft compact proposal. I have attended meetings with the MCA design team or working group in Honduras, and a range of social sectors, including local business councils, government officials, and local and international NGOs. Information on the proposal has been posted on the web and a portal was opened to receive comments on-line. The original proposal has been scaled down and its focus has tightened, partly in response to comments from Hondurans, and partly in response to those from the MCC.

Despite these commendable efforts, in Honduras our local partners, including the local Church, have expressed doubts about the extent of citizen ownership. Local citizens groups do not necessarily share the priorities set forth in the compact proposal; they do not feel that they were consulted sufficiently; and they have expressed reservations about the compact proposal in general. They also detect a bias in the way the MCC working group selected its audience, with a heavy predominance of private businesses, government, and government-aligned groups such as COHEP and FONAC.<sup>2</sup>

Hondurans understand the complexities of convening meetings of diverse groups representing the various social sectors, and they know from their own experience that it takes time and money. But they also believe that the MCA design team could have ensured better feedback. Web-based communications and tight feedback deadlines are inappropriate for most parts of rural Honduras. As a result, many valid opinions were effectively ignored. In the Honduran countryside, I can assure you that 9 people out of 10 have never heard of the MCC or its stated goals.

The Honduran government has asserted that its MCC proposal is based on the consultations underlying the Poverty Reduction Strategy Paper (PRSP), but this process (which was instituted in 2000 as part of the HIPC debt reduction initiative)

<sup>1</sup>UNDP Human Development Report 2003

<sup>2</sup>COHEP is the private business council, and many of its members are on the Tegucigalpa Chamber of Commerce. FONAC is a government-funded organization that serves as a proxy for civil society consultations, but few consider it an independent, representative organization.

fell short of its promise. While the PRSP process was a watershed event in Honduras in that it for the first time engaged the country as a whole in a comprehensive analysis of poverty and its root causes, many Hondurans were left disillusioned by the process. The final product, in their opinion, did not adequately reflect their feedback. Meetings to discuss the content of the PRSP were called on short notice and did not offer opportunities for effective dialogue, but rather consisted of presentations followed by Q&A sessions. Lately, there have been some encouraging signs that the consultative process governing the PRSP is gaining momentum: civil society representation on the PRSP Consultative Council (the body overseeing the implementation of the PRSP) has been expanded, giving civil society a majority representation. An agreement was also reached to at least partially fund the so-called “regional PRSPs” that—in contrast to the central government’s PRSP—were devised with extensive citizen participation by the local Church, farmers associations, women’s organizations, NGO umbrella groups, and other social sectors. These positive developments on the PRSP can serve as a guide for the MCC and partner governments as it seeks to include civil society more effectively in its planning and governing structures. In a word, *I applaud the Honduran MCC’s design team and working group for including at least some civil society representatives on the proposed governing council for the compact, but urge the designers to expand and strengthen the voice of local actors, institutionalizing their role in decision-making.*

It is critical to understand why CRS emphasizes so strongly the importance of meaningful local participation in the MCC. In our 60 years of development experience, the central lesson we have learned is that development programs are only effective if they are locally designed and implemented by the intended beneficiaries. Citizen groups and local communities have a vital role to play in assessing problems, prioritizing investments, and identifying practical approaches to carrying out projects. When it is informed and armed with sufficient resources (technical or financial) to organize, civil society is more likely to hold governments accountable than donors. Independent social audit mechanisms and citizen oversight committees are two mechanisms that have proven effective for CRS in the Latin American and African contexts.

*I will now address some specific issues related to the content of the Honduras compact proposal that in my view merit a closer examination.*

First, the latest version of the compact (which has not been made available to the public as such; a summary presentation on the changes to the original is available on the website) consists of two major investments: roads infrastructure and agricultural development. On the first of these, my question is: Who will be the primary beneficiaries of such road improvements?

Although the compact does envision the construction and improvement of feeder roads that connect farms to markets, it is as yet unclear where these secondary and tertiary roads will be built. Unless the roads reach into those parts of the country where the largest concentrations of poor farmers are to be found, the impact of road improvements on reducing poverty is questionable, at least in the short term.

The danger is that these investments will end up benefiting those farmers, transporters and businesses that are already comparatively better off, such as those living near or using the main north-south highway. I can also attest to the need for better roads *and better road safety*, having traveled earlier this week on the portion of the main highway that is to be improved with MCA funds. Under the best conditions, the trip is harrowing and time-consuming. The construction of an additional lane may indeed increase travel speeds and therefore reduce transportation costs. However, faster traffic also means greater risks in terms of safety, and the already appallingly high accident and death rate on the main north-south highway, is likely to *increase* unless road improvements are accompanied by concerted road safety campaigns consisting of education, training, and enforcement of speed limits.

Second, the provision of technical assistance (TA) to farmers also needs attention. I agree that Honduran farmers need training in better agricultural practices, crop diversification, efficient production and processing, and marketing to enable them not only to subsist but also compete in an increasingly global economy. My concern has to do with the mechanism the compact proposal envisions for delivering such TA, which appears to rely heavily on consultants and private TA firms that will be contracted to impart technical services to interested farmer groups.

In my experience, targeted technical assistance has the best chance of being applied, replicated and sustained when farmers are involved as active participants, not mere recipients of technical know-how. The starting point for any rural development strategy should be community organization and institutional capacity-building, so that the activities being promoted can rest on a solid and lasting social structure. In addition, training activities need follow up to monitor whether the technical assistance is being applied, and if not, to find out why not. The MCA should ensure

that credible organizations with proven track records are selected to accompany rural communities before, during and after the delivery of TA, and that sufficient funds are made available to provide this kind of follow-up.

Furthermore, the compact should lay out a far clearer strategy for addressing the needs of women, especially as it pertains to TA. In the Honduran context, where women play a key role in agricultural transformation and processing, TA should be geared towards those activities on which women spend the most time, such as canning, pressing juice, and packaging.

Third, better and more affordable credit to the small rural farmer is also a key component of a successful rural development strategy, but the MCC proposal fails to state which farmers, i.e. which economic or geographical group, will be targeted. If credit is to be extended primarily to those farmers who more competitively positioned to take advantage of the existing market linkages, the poorer, more remote farmers will be at a competitive disadvantage and inequalities will increase further. Achieving balanced growth will require a fair and effective microcredit program.

I understand my fellow CRS country representatives and partners in MCA eligible countries, such as Madagascar and Nicaragua, have raised some of the same issues and concerns about participation and the impact of growth on the poorest.

Now that I have illustrated the specific case of Honduras, let me end on behalf of *Catholic Relief Services* by respectfully submitting the following recommendations for consideration by the House:

- 1) Refer to section 609(d): "In entering into a compact, the United States shall seek to ensure that the government of an eligible country—(1) takes into account *the local-level perspectives of the rural and urban poor, including women*, in the eligible country," when considering reauthorization for MCA funding in FY 06. Enabling the participation of the poor is the best safeguard to ensure achievement of the MCC's overall objective of poverty reduction.
- 2) Design programs through consideration of the full range (beyond PRSP) of existing citizens' initiatives related to poverty reduction, such as the "Regional PRSPs" in Honduras; monitor and evaluate programs by employing participatory processes such as *social audit mechanisms* to ensure that the poorest and most vulnerable groups such as women are being reached.
- 3) Take additional steps to identify explicit coordination and communication mechanisms between MCC and key actors in development aid. As the GAO report indicates, the MCC has already taken initial steps in this direction.
- 4) Ensure that funding for the MCA is *additional* to existing development accounts, because poor countries need social as well as economic investments to effectively fight poverty.

In conclusion, I want to thank the Committee for your support of innovative initiatives such as the MCC that both help to stimulate economic growth and combat global poverty. I also commend the Chairman and Ranking Member for your stalwart support of non-governmental organizations such as Catholic Relief Services in Honduras. I welcome the opportunity to respond to any questions you may have.

Chairman HYDE. Thank you very much, Mr. Walsh.

I am greatly impressed by the caliber of witnesses. You three are very knowledgeable, insightful, have made a real contribution to our understanding of this program, which is a marvelous idea, but it still seems to be potential despite the passage of time. You have highlighted some weaknesses, vulnerabilities. The understaffing can be pretty fundamental because the problems that Mr. Walsh mentions in Honduras require personnel on the ground to see what is going on and to interface with the local people and to get programs that will work.

I do not intend to hold you here much longer with oral questions, but I would like to write some questions and send them to you, and if you would answer them, it can be a more thoughtful process, and I can absorb your answers better.

But I think this program must not fail, and if there are shortcomings at its inception, and you have highlighted many of them, let us address those. Let us address those, and we will.

So I will be in touch with you with some questions that I would like to receive answers for, and I know that they will be informed.

So, Mrs. McCollum?

Ms. MCCOLLUM. Mr. Chair, this was a very timely hearing, as President Bush goes forward with G-8 meetings and as the world is watching to see if we mean what we say when it comes to poverty reduction. I have found particularly disturbing—and I am going to work with Mr. Applegarth and the MCC about the environmental standards that, in my opinion, appear to be lacking. I will look at the Web site and work with them. So, Mr. Chair, if I need some help, or if you think it is best that I submit that in question form so that the Committee can see all of it, I will have my staff work with your staff on that.

Another point that did not get addressed that Mr. Lantos raised was Madagascar. Rural citizens in Madagascar live on 41 cents a day, and the Millennium grant, as Mr. Lantos pointed out, is going to go to modernizing the country's land-title system and its banks. Now, I am not saying that those are not noble things to do so that people have confidence in investing in the community, but I do not believe that the people who are living on 41 cents a day, the overwhelming majority of people in Madagascar, are going to be benefiting greatly from land reforms because they probably are not going to be able to afford to buy land, and we have heard from the testimony that they are not using the banks.

So I think we have opportunities to make this program a success, and I look forward to working with your staff and the Administration to make that so.

Thank you, Mr. Chair.

Chairman HYDE. Well, I want to thank you very much for a solid contribution. This is only the beginning of our concern with this program. You have made a contribution. Thank you.

The Committee stands adjourned.

[Whereupon, at 1:03 p.m., the Committee was adjourned.]



A P P E N D I X

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MATERIAL SUBMITTED FOR THE HEARING RECORD

RESPONSES FROM THE HONORABLE PAUL V. APPLGARH, CHIEF EXECUTIVE OFFICER,  
MILLENNIUM CHALLENGE CORPORATION, TO QUESTIONS SUBMITTED FOR THE  
RECORD BY THE MEMBERS OF THE COMMITTEE ON INTERNATIONAL RELATIONS

*Congress has appropriated a total of \$2.5 billion to MCA over the last two years (\$1 billion in FY04 and \$1.5 billion in FY05), and the Administration has submitted a request for an additional \$3 billion in funding for FY 2006. As of today, however, only one compact has been signed in the amount of \$110 million, and no disbursements have been made. Mr. Applegarth's written testimony indicates that the Millennium Challenge Corporation (MCC) anticipates 22 compacts before the end of FY06 (12 with FY04 and FY05 funding, plus 6 with FY06 funding and 4 low-middle income compacts). His written testimony also claims that MCA will run out of money if the FY06 request is not fully funded. Considering that MCC has yet to fund even its first completed compact, with only four more compacts currently in negotiation, and eligible low-middle income countries not even announced yet, it seems that lack of funding is not the problem and having 22 compacts in place in the next 17 months is highly unlikely.*

**1) How do you get 22 compacts in the next 17 months when only one is complete, only four are currently in negotiation, there are only 17 eligible countries total, and low-middle income countries are yet to be announced? (This is nearly the equivalent of one compact every three weeks.)**

ANSWER: It is important to distinguish between the time MCC signs (or commits funds under) a Compact, on the one hand, and the time MCC carries out disbursements of funds under a Compact, on the other. Disbursement of the full Compact amount is not made upon signing, but is carried out in tranches during the term of the Compact. In other words, MCC commits upfront the full amount of the Compact, but disburses such amounts in tranches over the term of the Compact. Thus, before MCC can sign a Compact it must have sufficient appropriated funds to cover the full amount of that Compact.

At present MCC will be able to sign only approximately 12 compacts with MCC's combined FY04 and FY 05 appropriations. Thus, additional FY 06 funding will be needed in order to be able to sign compacts with the remaining 5 currently eligible countries and with any additional eligible countries chosen in FY06.

MCC has currently signed Compacts with Madagascar, Honduras, Cape Verde and Nicaragua. Negotiations with Georgia are progressing well and we expect to sign a Compact with Georgia in September. That will be five Compacts this fiscal year. Already we see a number of other countries moving rapidly in refining their program proposals and we hope to sign Compacts with 7-9 more countries by the spring of 2006. Programs in some countries are complex because of the need for environmental and feasibility analyses and may result in compacts being signed later in 2006. We have also signed 609(g) agreements with a number of countries to facilitate development of their compacts. Also, in November of this year we expect a new group of countries to be selected as eligible for MCA assistance. This will include lower middle income countries (LMIC) for the first time.



With regard to timing, given the greater capacity and resources in the LMIC countries compared to many low – income countries, it is possible that the time needed for MCC to assist in program development and to conduct due diligence will be shorter, therefore, a Compact could be signed with these countries more quickly.

**2) Can you please explain the time line, country by country, in which you will spend the \$2 billion that has already been appropriated to the MCA? Can you also explain the time line to spend the additional \$3 billion you have requested for FY 2006? Your written testimony does not give specifics on how the countries would line up in the coming months?**

ANSWER: Compacts with approximately 12 of the initial 17 eligible countries, along with administrative, audit, due diligence and Threshold Program costs, are expected to commit all MCA appropriations to date. Thus, additional FY06 funding is needed in order to sign compacts with the remaining 5 currently eligible countries, plus any additional countries that may become eligible in FY06. MCC's qualification criteria and selection process remain transparent, and are based on the most current data available at the time of selection. As this data is not yet available, it is impossible to identify which countries will meet the criteria; it is equally not possible to anticipate precisely which countries will be selected by the MCC Board as eligible for FY 06. We do expect the country selection for FY06 in November will result in additional low income countries and, for the first time, low-middle income countries. We further expect our average compact size to increase substantially as MCC provides additional guidance and eligible countries gain experience in formulating transformative programs. Thus, MCC believes that the remaining 5 currently eligible countries and any newly chosen countries will fully utilize the additional \$3 billion requested. Given that the countries are not yet known, the time they will take in their consultative process, or the substance and complexity of their proposals, any estimate of the timing for signing Compacts with these new countries would be speculative.

**3) How long do countries have to finalize a Compact with the MCC before they are no longer considered to be eligible to receive assistance?**

ANSWER: At present, there is not a time limit. We currently engage each country to explain requirements, procedures and conditions necessary to complete a Compact. If a country is not progressing in defining a viable program that promotes poverty reduction through economic growth, we continue to assist them to try to refine the program. To date, MCC has received proposals as early as three and a half months after selection and as late as eleven months after selection. The quality of the programs proposed is where MCC has placed its focus. MCC is currently developing its policy on when a country would no longer be considered eligible to receive assistance.

**4) The Administration almost certainly will put in a request for FY07 for several billion more dollars for MCC, perhaps at the full \$5 billion. Isn't FY07 problematic for MCC in that, if MCC falls short of its intended number of completed compacts, it will still have**

**significant funding left over from FY04-FY06? On the other hand, if MCC completes all its expected compacts, how will MCC spend \$5 billion more dollars in FY07 when most of the compacts will have already been negotiated and paid for?**

ANSWER: As outlined above, MCC does not expect to have funding left over from FY04--06 as the money will have been completely committed or reserved for Compacts with eligible countries which will still be in the process of implementation. For FY07 and forward, MCC expects that some countries successfully completing Threshold Programs will become eligible. Moreover, as MCC's model is more widely accepted, it is anticipated countries will progress on the policy reforms required to qualify for MCA assistance. Consequently, we expect the pool of both low and low-middle income countries to expand, leaving ample scope for growth of the program along with growth of the average Compact size, matching progress in appropriations.

**5) In determining eligibility for FY2004 and FY2005, the MCC Board did not select approximately 13 countries which seemed to have passed the indicator criteria. These countries include Bhutan, Burkina Faso, China, Djibouti, Egypt, Guyana, Nepal, Philippines, Swaziland, and Vietnam. Why do you think that the Board did not select these countries?**

ANSWER: MCC's Board of Directors evaluates policy performance and selects countries based on performance in three categories: Ruling Justly, Investing in People and Encouraging Economic Freedom. The Board uses 16 policy indicators to measure policies in these areas. The indicator scores are the predominant basis for determining which countries will be eligible for MCA assistance. The MCC Board considers whether countries score above the median on half of the indicators in each category and whether the country scores above the median on the corruption indicator. Additionally, if a country performs substantially below the median the Board can consider whether the country has taken any corrective action to address the weakness. Finally, the Board members can take into account supplemental information about performance on these policies to adjust for weaknesses, gaps and lags in the data and to account for positive or negative trends not reflected in the data. All of the countries mentioned above either perform substantially below the median in one or more indicators or show downward trends in the policy areas of concern to the Board. We would be happy to provide a detailed confidential briefing on the policy performance of these countries.

*Similarly, the completion of the four-year, \$110 million compact with Madagascar, while a milestone for the MCC, has led many to question whether the MCC will be able to fully spend the funding that it has received from Congress. In order for the MCC to fully disburse the more than \$2.5 billion in FY06 funding, the MCC may need to substantially increase the size of future compacts or increase the number of eligible countries, or some combination of the two. As we assess whether it will be possible for the MCA to effectively spend these monies, it would be helpful if you could answer the following questions:*

**6) What do you expect to be the average size of MCA compacts when finalized? What was the assumption regarding compact size when MCA was announced? What was the average**

**size of the proposed compact when originally requested by the countries? Why the differences? Why were they downsized?**

ANSWER: MCC does not have a formula for allocating funds across countries but, rather, reviews individual country proposals in terms of viability, likely impact, contribution to poverty reduction, and economic rates of return for the program. Ultimately, MCC aims to be transformational to the extent its funding permits.

At this time, MCC has received proposals from 16 countries of the 17 eligible countries. Current funding requests range from \$38 million to \$350 million, with an average of over \$200 million (after changes based on an initial assessment of poverty reduction potential and economic rates of return on various proposed activities). Generally the proposed timeframes are about 4 years. As mentioned above, MCC commits all funds for a proposal at the time of signing the Compact for the entire term of the Compact.

In several cases the amount committed or planned to be committed under Compacts exceed the original amount requested. The variation from the original amount requested can be due to several reasons, including the deletion or modification of components because they did not have an adequate economic benefit or did not arise from a consultative process, or because due diligence revealed that a greater investment would be needed for the Compact program to be successful.

**7) Is the U. S. one of the top three donors in Madagascar? In the four other countries which are currently finalizing Compacts with the MCC (Honduras, Nicaragua, Georgia, and CapeVerde), how will the MCA program rank in comparison with other donors in those countries?**

ANSWER: The most consistent and comparable data on donor aid flows is compiled by the OECD's Development Assistance Committee (DAC). The DAC's most recent data on a country-by-country basis is reported as an average of 2002-2003 official development assistance (ODA) provided by each donor. Data on 2004 assistance flows will not be available until later this year.

Based on the 2002-2003 data, the U.S. was the fourth largest donor to Madagascar. It provided an average of \$42 million per year in 2002-2003, behind IDA (\$195 million), France (\$99 million), and the European Commission (\$69 million). The MCC compact, valued at \$110 million over four years, or an average of \$27.5 million per year, would make the U.S. roughly equivalent to the EC in the rankings of donors, provided all donors continue to provide the same average annual amount of ODA over the coming four years as they did over 2002-2003.

In Honduras, the U.S. was the largest donor over the period 2001-2002 (the most recent DAC data available for Honduras), providing an average of \$149 million per year over these two years. The second largest donor, IDA, provided an average of \$90 million per year in ODA. The MCC compact of \$215 million over five years would increase the U.S. total by an average of \$43 million per year.

In Nicaragua, the U.S. was the fourth largest donor in 2002-2003, behind the IDB (\$105 million), IDA (\$100 million), and Germany (\$95 million). The U.S. provided \$68 million per year on average in 2002-2003. The five-year, \$175 million MCC Compact would provide an average of \$35 million per year, placing the U.S. just behind the IDB as the largest donor in the country, provided all donors continue to provide the same amount of assistance in the coming years as they did in 2002-2003.

According to the same analysis, the MCC's five-year, \$110 million compact with Cape Verde would make the U.S. the top donor there at about \$27 million per year, just ahead of Portugal (\$26 million per year over 2002-2003). In 2002-2003, the U.S. was the 7<sup>th</sup> largest donor, providing \$5 million per year in ODA.

The final size of the Georgia compact has not yet been determined, but should be around \$295 Million. In 2002-2003, however, the U.S. was the largest donor to Georgia, providing \$104 million per year on average. The second largest donor, IDA, provided \$51 million in ODA per year.

**8) Will expanding the number of eligible countries much beyond the current number dilute the integrity of MCA in terms of rewarding best performers? If MCA ultimately consists of several dozen \$100 million compacts, how is that "transformational" for the best performers? If that happens, doesn't MCA become just another development program?**

ANSWER: It is very unlikely that the MCA will ultimately consist of several dozen \$100 million Compacts. In fact the average size of the proposals that MCC has received from 16 of the 17 eligible countries is over \$200 million. Madagascar's Compact is envisioned as the first step of a two phase effort with the second phase being substantially larger. Cape Verde is also quite large in per capita terms. However, MCA's ability to be "transformational" goes far beyond the amount of money we disburse. If we can cause vital policy reforms in countries--both eligible and those who wish to become eligible--these changes will improve the material well-being of poor people, whether or not their governments ever sign an MCA Compact. From what we have observed so far, the MCA is causing that kind of transformation.

However, it is also true that the incentive effect is related to the overall size of MCA's resource pool. This is one of the reasons it is important to continue MCA funding at levels that make eligibility sufficiently attractive for countries to continue to make these difficult reforms.

**9) How much actual change in economic growth and poverty reduction is likely to occur as a result of compacts of this limited size?**

ANSWER: As mentioned above, we do not expect the MCA to consist of merely \$100 million Compacts. However, experience has shown that dollar amounts are not the best measurement of the impact a program will have. The focus should rather be on the addressing the true bottlenecks to growth. MCC is concentrating on creating the largest impact possible given the

resources at our disposal. In the process of assessing compacts, the economic rate of return and poverty-reduction impact of each element of each proposal is evaluated. Elements of the Honduras compact, signed last month have expected economic rates of return ranging from 21% to as high as 40%.

MCC does not have a formula for allocating funds across countries, but rather reviews individual country proposals in terms of viability and likely impact, contribution to poverty reduction, and economic rates of return.

However, the full impact of the compacts should not be seen only in the direct economic return on our aid dollars. No less important are the incentives MCA creates for good governance and economic policy. It is now widely accepted that economic growth is tied to good governance and good economic policy and that aid is more effective where such good policies are in place.

*The United States, for example, has historically been a minor donor in Madagascar, the first country to complete an MCA compact. The \$110 million, four-year compact works out to be about \$28 million per year. However, even with MCA, U.S. development assistance in Madagascar is still less than half of what the third largest donor contributes in Madagascar (World Bank \$178, France \$90 million, and EC \$78 million).*

**10) Given that MCA is supposed to have a "transformational" effect on a country's development how is the Madagascar compact transformational?**

ANSWER: The Madagascar Compact will support a program designed to raise incomes in rural areas by enabling better land use, expansion of the financial sector, and increased investment in farms and other rural businesses. Secure property rights encourage rural producers to protect and increase investments in their land. In addition, land titles and certificates can serve as guarantees for loans, assuming other conditions are conducive to rural lending. For this to occur, reform of the banking sector must allow for increased credit to flow to the rural areas. Lastly, identification and promotion of investment opportunities and technical assistance will attract private sector actors to invest in a more financially stable, land secure environment. By the end of the Compact term, the program aims to title approximately 250,000 hectares of land, benefiting about 62,000 households, increase lending in the target areas by about \$30 million, and significantly increase the number of rural producers that adopt new technologies or engage in higher value production. If these objectives are achieved, the MCA program will have had a transformational effect on poor populations in the targeted rural areas, and will have provided valuable lessons for expanding reforms to other areas.

**11) If MCA is well behind even the third largest donor in a country, how can it have an influence to effect real change in a country, particularly regarding reform and corruption?**

ANSWER: Our objective is to be one of the largest donors in a country, which is another reason MCC needs to be fully funded. However, it is now widely accepted that economic growth is tied to good governance and good economic policy and that aid is more effective where such good

policies are in place. Tying MCA eligibility to a country's performance on the indicators creates an incentive for countries to adopt policies that promote economic growth and poverty reduction and to maintain those policies after a compact has been approved. Now that our criteria for selection and country scores have been publicly available for more than a year, we are seeing notable evidence of the incentive effect of our indicators. We see a great deal of attention to the indicators by governments who regularly visit us, other U.S. Government agencies, and the institutions that collect the data for the indicators to discuss the indicators, the cause for the weaknesses and how they can make improvements. We believe we are providing a tool for reformers both inside and outside government to push for changes. Finally, we are seeing actual improvement by countries on the indicator scores.

**12) Do you anticipate adding amendments to existing compacts that might significantly boost the scope and funding of the compact? What will be the funding size of such amendments? How will this process occur and under what legal authorities? Will it need to go through some additional review processes to assess its adherence to and implementation of the original compact?**

ANSWER: We have anticipated making amendments to existing Compacts to boost the scope and funding. Many countries have submitted ambitious, complex programs that have different parts to them. Some parts are further developed and it would make sense for MCC to obligate funds against those parts while still working through the complicated due diligence issues of other parts. One drawback of doing this is that Congress has mandated a five-year deadline on programs. This has the effect of slowing down signing a Compact until all parts can be developed. Therefore, MCC believes that amendments will need to be made in Compacts as we learn more in the process, though the five-year deadline will be a deterrent -- at times -- to making more of a transformational impact. It is impossible to predict the size of such amendments since this would be dependent on the country context; however, we would anticipate that the process that would be followed would be very similar to that followed in approving the original Compact.

*There are 11 other countries (Armenia, Benin, Bolivia, Ghana, Lesotho, Mali, Mongolia, Mozambique, Senegal, Sri Lanka, and Vanuatu) for whom MCC has been attempting to negotiate compacts for 12 months now.*

**13) Why haven't these 11 countries made the same kind of progress that the first five have, given that they started at the same time?**

ANSWER: Progress in successfully negotiating a Compact for MCA funding is very much dependent on the host country's commitment to identifying a program and putting human and other resources behind the effort. We have seen that in the first five countries, the host governments have named MCA teams who have put significant, full-time effort into putting together a proposal and working with the MCC to ensure adequate due diligence for the components of the program. Some countries have proposed projects of such complexity that feasibility and environmental studies will necessarily delay finalizing a Compact. Other

countries that have not progressed as rapidly have either not clearly defined a fundable program and/or have not provided sufficient counterparts for the MCC to engage in helping address criteria for program funding. Others have been delayed as a result of political turmoil or natural disasters.

**14) What is the expected time table for each of these countries to complete compacts?**

ANSWER: Already Compacts have been signed with the Republic of Madagascar, the Republic of Honduras, Nicaragua and Cape Verde. We have negotiated a Compact with Georgia and the Board has approved it.

The timing for the other 12 eligible countries varies, depending often on the intensity and quality of the host country effort in developing a fundable proposal, although we hope to have Compacts signed with 7-9 of these countries by the spring of 2006.

No country is at a point where we feel that outright rejection of a program is warranted.

**15) Which of these are furthest behind? What is causing the delays?**

ANSWER: Including Morocco, chosen by the MCC Board in November 2005, we presently have 17 eligible countries. We have Board approved compacts in five countries: Madagascar, Honduras, Cape Verde, and Nicaragua and Georgia. In the remainder of the Compact "pipeline," we are actively engaged with the governments to move forward as quickly as possible. In some cases, the process is moving slowly, notwithstanding our efforts. The reasons for delay vary and can relate to lack of commitment to an open consultative process, political turmoil, natural disaster, etc. In a couple of cases, the delay is due to the complexity of the proposed projects.

MCC takes responsibility for other delays. We have tried to maintain a feedback mechanism with ourselves, the Administration, Congress, outside groups, and most important, the countries themselves, to learn what we can do better. For instance, we have become much more prolific in our guidance to countries than was originally the case. We have also used 609 (g) technical assistance more aggressively to assist countries.

At this point, no country is at a point where we feel that outright rejection of a program is warranted.

*Low-Middle Income countries become eligible for MCA funding in 2006.*

**16) How many of these countries do you expect will be determined to be eligible? Which countries are in the pool of candidates? What is the likelihood that MCC will have compacts negotiated and signed before the end of FY 2006? How many do you expect?**

ANSWER: All lower-middle income countries (LMIC), based on the World Bank's income classification, which are not prohibited to receive assistance based on statutory provisions, will

be candidates for MCA assistance in FY2006. The MCC Board has identified 29 countries in this category. From this pool of candidate countries, eligibility will be determined based on countries' performance on MCC's indicators. Countries in this income category will be competing against their peers, separate from the competition in the lower-income country category. While there is no predetermined number of slots for eligible LMICs, the Board will likely take into account the funds available and the 25% cap on funds for LMICs, when selecting countries eligible for funding.

It is difficult to predict the exact number of compacts that will be signed in FY2006. This is largely dependent on the ability of eligible countries to design proposals that address the bottlenecks to growth in their countries. Any predetermined quotas for approved compacts would most certainly hurt the quality of the compact proposals that countries are designing. It is hoped that the LMICs, which have more resources than those in the lower-income category, will be able to engage faster and develop proposals more quickly. Lacking a track record in dealing with the LMICs, however, this is speculation.

**17) What is your expectation regarding the potential size of these compacts, compared with the poor MCA countries?**

ANSWER: There is no pre-set size of any given compact. The amount of funding depends on the proposal itself, which is evaluated based on its viability, likely impact, contribution to poverty reduction, and economic rates of return. However, the legislative cap of 25% of annual appropriations to lower-middle income countries will ensure that the majority of MCC's resources continue to be used to assist the poorest countries.

**18) What are your views regarding possibly postponing low-middle income compacts in order to focus on getting the low income compacts in place and funded?**

ANSWER: Our resources are primarily targeted for the countries in the lowest income category. At the same time, we have to remember that lower-middle income countries also have large populations living in extreme poverty and it is important that MCC not neglect these people. The incentive effects of participation in the MCA process in terms of good policies and governance would be endangered if MCC had to postpone bringing countries in the lower-middle income category into the process. This highlights the importance of funding for the MCC at a level to allow engagement with both lower-income and lower-middle-income countries.

*Poverty Reduction.*

**19) Understanding that MCA has a dual goal of economic growth and poverty reduction, what steps is MCC taking to ensure that poverty reduction occurs? What steps are you taking to ensure that poverty are reduced primarily through advance in the private sector? What steps are you taking to ensure that the greatest economic benefits from private sector**



**initiatives are reaped by the poorest people, rather than by those who may already own the businesses or the banks?**

ANSWER: MCC's mission is to help countries lift the most people out of poverty by supporting sustained economic growth that benefits poor people. Before agreeing to fund a program, MCC works with each country to estimate the economic returns AND identify which segments of the population are likely to benefit from those returns. The purpose of this analysis is to target funding to activities that are likely to have the highest poverty reduction impact. Increasing incomes of poor people over the long-term relies on growth of the private sector. In each funding decision, MCC considers whether the program addresses the major constraints to economic growth facing a country, whether growth will occur in sectors or regions which will benefit the poor, and whether the program will promote or crowd-out private investment, which is contrary to MCC's mission.

Some examples of the economic growth and poverty reduction objectives are discussed below:

- In Madagascar, the MCA program aims to title approximately 250,000 hectares of land, benefiting about 62,000 households in rural areas, increase lending in the target areas by about \$30 million, and significantly increase the number of rural producers that adopt new technologies or engage in higher value production
- In Honduras, the MCA program will enable Honduran farmers to improve business skills, productivity, market access and risk management practices resulting in higher incomes through an increase in number of farmers and number of hectares involved in harvesting new high value horticulture crops of 8,000 and 14,000, respectively. To ensure that poorer farmers are reached, the program will work with farmers that own, on average, 5 hectares of land or less.
- In Nicaragua, the MCA program will focus on one region in Nicaragua, the Departments of Leon and Chinandega, home to some of the most extreme poverty in the Western Hemisphere. The Program will a) strengthen investment in approximately 70% of rural properties in the region of León through a property regularization project, b) reduce transportation costs between the region and regional, domestic and international markets through primary and secondary road upgrading and c) support approximately 5,560 farmers in upgrading to higher-value agriculture through MCA's Rural Business Development Project.
- In Cape Verde, the MCA program aims to develop agriculture capacity and water management across three islands, benefiting more than 70,000 poor farmers. The program will also increase access to markets, social services and employment opportunities through improving the rural road network for approximately 60,000 Cape Verdeans. By removing significant constraints to private sector development, such as increasing the efficiency of the Port of Praia, the MCA program will also increase job availability for the poor in Cape Verde.

- In Georgia, the MCA program could reduce the incidence of poverty in targeted Samtskhe-Javakheti, the poorest region in Georgia, by 12 percent and create 24,000 jobs nationwide through rehabilitating regional infrastructure by improving transportation for regional trade, rehabilitating a major gas pipeline to ensure a more reliable energy supply and making regional and municipal infrastructure services more available. The MCA program also aims to promote private sector development, particularly in agribusiness, by investing long-term risk capital, improving the skills and capacity of small and medium enterprises (SMEs), and providing funding and technical assistance to farms and regional businesses.
- Similarly, the 609(g) agreements to prepare for Compacts in Lesotho and Senegal will lay the ground work for major development programs that should reduce barriers to private sector investment and have a large impact on the poor.

*Consultation. One of the key tenets of the MCA is that developing countries should lead the design of the assistance package, be principally responsible for administering the program and be held accountable for results.*

**20) What efforts have been made to ensure that civil society, local interests, business associations and other relatively small groups are consulted and are being made part of the compact-making process within MCA countries? How are you ensuring that MCA countries are not just piggy-backing on their previous poverty reduction plans and claiming fresh consultations within their countries?**

ANSWER: MCC is committed to the consultative process as a core element of country ownership, Compact development and implementation. MCC expects governments in eligible countries to manage a transparent, ongoing process that provides opportunities for citizens to have input into the identification, prioritization and design of development programs proposed for MCC funding. This is evaluated during due diligence.

MCC has issued public guidance to help MCC's partners understand how MCC will evaluate consultative processes: A good consultative process is (1) timely (early in the process and of an ongoing nature), (2) broadly participatory, and (3) meaningful (a genuine, two-way dialogue that is reflected in the program). MCC reinforces the guidance in their discussions with country counterparts and, if they see weaknesses, engages in discussions about how to improve the process. Since the consultative process should be ongoing, countries that have not undertaken sufficient efforts can work on improving them. To that end, the guidance outlines what we see as a good process, gives examples of methods for communication and two-way dialogue, and offers a set of illustrative questions that countries can use to evaluate whether they are meeting the objectives of a consultative process. It also specifically addresses whether consultations done previously for a country's Poverty Reduction Strategy Paper (PRSP) will suffice. While we believe these consultations can form the initial basis for the MCA proposal, countries should continue public dialogue associated with these national plans and provide feedback and justification on how and why priorities for MCA assistance were identified from the PRSP.

MCC has hosted a number of “Lessons Learned” workshops for MCA countries and we have encouraged countries to contact each other regarding their experiences.

**21) None of the finalized or soon-to-be-finalized Compacts include a basic education or basic health component. This is curious since The Wall Street Journal reported on April 18, 2005 that a senior MCC official discouraged Malagasy officials from pursuing health and education projects in initial consultations. Did Madagascar’s original proposal for MCA include basic health and education? Is the MCC discouraging countries from including basic health or basic education in its Compact proposals?**

ANSWER: No and No.

About three weeks after MCC’s Board selected Madagascar (May 6, 2004), MCC had its initial team visit. This was part of MCC’s efforts to visit all the newly-named eligible countries. To the credit of the Malagasy government, representatives of its private sector and civil society groups, they had already started working on the process. When MCC’s team arrived in country, Madagascar presented a slide show presentation regarding five different concepts that could form the basis of an MCC proposal. The concepts included private-sector development, provision of clean water, agriculture, health facilities, and education. The MCC official referenced neither discouraged the Malagasy on any of their ideas nor explicitly encouraged any particular idea. MCC stands ready to work with countries that propose good quality programs that address basic health or education needs, as the recent Burkina Faso Threshold program targeted to girl’s primary education indicator. MCC believes that those ideas should come from the country – not from Washington – because it is the country that has a better idea as to what are its priorities, what are other donors doing, and how MCA funding can be utilized to reduce poverty in that context.

**22) Other than for the purpose of developing data baselines, the MCC has been reluctant to extend assistance under section 609(g) of the Millennium Challenge Act of 2003 to eligible countries to help them develop Compact proposals. Some countries, including Mongolia Honduras and Nicaragua, have instead secured funding from regional development banks or foundations for these purposes. Others, like Mozambique, have struggled to comply fully with the requirement of civil society participation because the government lacks funds to meet a broad spectrum of stakeholders in such a large country. Under what circumstances you think that the MCC should financially support the development of Compact proposals?**

ANSWER: MCC has in fact used 609(g) funds for several different purposes and has signed 609(g) agreements with seven countries. In general, MCC believes that eligible countries should own and manage the identification of their priorities for poverty reduction through sustainable economic growth as well as the process of proposal development, and MCC encourages a country to look to and consult with its own citizens and resources in order to maximize country ownership of the proposal. However, during MCC’s discussion with the country of its proposal for MCA funding, technical assistance different from typical program assessment, evaluation,

and design work may be warranted, which is the purpose of 609(g) funding. While it is difficult to anticipate every scenario, 609(g) assistance could address such things as the economic reasoning of the proposal, statistical issues or baseline surveys, engineering feasibility and design, and environmental impact assessments. MCC will consider 609(g) funding for Compact development and implementation activities only in the event of a demonstrated and justified need for such funding. In determining whether to provide 609(g) funding, during its preliminary evaluation of the proposal, MCC will analyze such factors as the country's consultative process, whether the proposal is likely to generate meaningful economic benefits, and whether the country has demonstrated a significant commitment of human and financial resources to the identification of priorities and development of the proposal. In addition, MCC must be satisfied that adequate financial controls, in terms of financial management and procurement processes, have been identified and that the country has developed an acceptable work plan (with timeline and estimated budget) for use of the 609(g) funding. Other restrictions or requirements may apply as appropriate, including any statutory requirements.

A commitment by MCC to provide 609(g) funding is not a guarantee that a Compact agreement will be reached or that a specific project associated with the 609(g) assistance will be funded by MCC. MCC's policy on 609(g) funding may be modified or amended at any time at the discretion of the MCC Chief Executive Officer.

*Judicial Corruption in Nicaragua. Dole Food Company and other multinational companies claim that they have been unfairly targeted for their past use of a pesticide by a Nicaraguan law and the corrupt Nicaraguan judiciary, including legal actions that prohibit these companies from defending themselves, which has resulted in judgments in excess of \$715 million so far. Nicaragua is currently negotiating a compact with MCC.*

**23) Is MCC aware of this alleged misconduct and corruption by the Nicaraguan courts? If such activities are found to be accurate how would it affect the viability of Nicaragua as a MCA country? Will you follow up with your Nicaraguan contacts on this issue?**

ANSWER: MCC is very aware of the allegations of judicial misconduct and corruption in Nicaragua and has been working closely with other parts of the U.S. administration, as well as with the administration in Nicaragua, to protect U.S. taxpayer funds and to find ways to increase pressures for judicial reform in Nicaragua. While MCC cannot speak to the accuracy of the specific claims of those raising issues with the Nicaraguan judiciary, it appears that the overall criticism of the system has merit. MCC is watching closely the political environment in Nicaragua and, under instructions from our Board, we will ensure that all parties understand that deterioration of the environment will cause a suspension or termination of assistance. We plan to work continuously with our Nicaraguan counterparts on this issue as well as other issues related to the criteria on which Nicaragua qualified for MCA assistance.

*Reporting.*

**24) Describe your system of monitoring and evaluating a compact's effectiveness in increasing economic growth and reduce poverty. Who will conduct the monitoring and evaluation? How can you ensure the independence and objectivity of the monitoring and evaluation reporting? Will Congress get to see the raw evaluations and assessments? How will the reports be published? What will be the process for providing feedback to the countries for mid-course corrections?**

ANSWER: Before implementing MCA Compacts, eligible countries and MCC must come to agreement on the objectives of the program and how progress towards those objectives will be measured. Monitoring and Evaluation (M&E) Plans document this agreement and establish a reporting and performance assessment schedule for each Compact.

#### MONITORING

Monitoring of program performance consists of tracking a number of critical indicators over time. In the short-term, the delivery of key goods and services will be tracked in order to monitor the pace of implementation. In addition, intermediate results of the activities will be tracked in order to provide an early measure of its likely impact. Finally, there will be regular assessment of program progress towards achieving the growth and poverty reduction goals. In general, MCC countries will monitor the activities to ensure that the delivery of key goods and services is occurring on schedule and within cost and that intermediate objectives are realized. MCC will also require countries to conduct periodic data-quality assessments to verify the quality and consistency of the data reported on indicators. For each indicator identified in the M&E Plan, the country will submit periodic progress reports to MCC and on the country's MCC website. By making this information publicly available, a variety of stakeholders will be able to monitor and comment on MCC progress. In addition, MCC will use monitoring data as a management tool to guide implementation and make mid-course corrections as needed, through discussions with the representative government and Compact program implementers.

#### EVALUATION

In addition to monitoring implementation of Compacts, MCC is committed to evaluating the impact of the programs on the beneficiaries. Impact evaluations help attribute specific activities to the objectives and estimate the magnitude of the relationship. The purpose of these evaluations is to provide important lessons to improve the effectiveness of future Compacts and of development programs. Impact evaluations will be conducted by independent parties unrelated to the country or to MCC to ensure objectivity in the estimates of the Program's impact. MCC hopes to engage top development scholars to perform these evaluations.

MCC believes that all monitoring and evaluation reports represent a public good that could benefit future development programs by providing lessons to increase their effectiveness.

#### *Poor Performers.*

**25) What is the formal process for informing countries when they are not performing to MCA standards? Is there a formal process, or just one that is ad hoc? What is the formal process for warning and, if necessary, removing a country from MCA eligibility?**

ANSWER: If the country falls below the median on any of the indicators originally used to determine eligibility, the MCC will engage the government directly on the facts and seek action by the government to address the negative changes. If the negative changes are significant, if the success of the Compact program is threatened, and/or if the government is not taking corrective action, then under paragraph Sec. 611(a) of the Millennium Challenge Act ("Act"), the CEO will consult with the Board to determine whether assistance should be terminated. Consistent with this legislation, assistance may be terminated by the CEO, after consultation with the Board, if the CEO determines that (1) the country or entity being supported is engaged in activities which are contrary to the national security interests of the United States; (2) the country or entity has engaged in a pattern of actions inconsistent with the criteria used to determine the eligibility of the country or entity, as the case may be; or (3) the country or entity has failed to adhere to its responsibilities under the Compact. If issues are raised in any of these three areas, MCC staff will prepare a briefing for the CEO who will consult with the Board on the facts. A final decision will be made by the CEO based on results of these Board consultations.

*Measures of Success.*

**26) Please describe how you will determine the success of an MCA compact with a country. What are your measures for determining whether a country's involvement with MCA has been a success or not?**

ANSWER: The measures of success will be established in each Compact, although the main criteria for determining the success of an MCA compact will be to measure the growth and poverty impacts of our programs. In many cases, MCC will track the household income as an indicator of economic growth and poverty reduction because a direct way to improve the standard of living of the poor and raise them out of poverty is through increasing their household income. In some cases, tracking income may not be possible; countries could propose other methods or measures as a substitute. MCC will fund impact evaluations to assess changes in household income (or other key variables) versus what income would have been absent the program.

For example, if the change in the income of the beneficiaries is significantly higher than what household income would have been absent the program -- and if that change justifies the cost of the program -- then MCC and our country partners would consider the program a success. To get a **reliable** picture of whether MCA funding was a success, evaluation methodologies need to be rigorous and often incorporated into program design.

For some projects, such as major infrastructure construction, five years may not represent a long enough period to see changes in beneficiary income. In these cases, MCC will track intermediate indicators of program success. Intermediate indicators, such as reduced transport costs due to infrastructure improvement, will provide an earlier indication of whether or not MCC programs have accomplished their objectives of economic growth.

Because the full poverty reduction impact may not occur within the Compact term, MCC may conduct impact evaluations after the compact ends to better understand the longer-term outcomes of MCC programs.

*Helping Country Compact Development. MCC is somewhat caught in the middle regarding the level of advice given to countries trying to develop compact proposals. On the one hand MCC rightly seeks to have countries develop their own proposals so they "own" them, but MCC also gets criticized because some believe that it does not give enough guidance to eligible countries.*

**27) Describe the balance that you believe must be made to ensure home-grown compacts that are timely. What are MCC's views of using "facilitators" in countries to help promote civil society consultation, proposal development and negotiation, and other steps necessary to conclude compacts more rapidly while maintaining quality and country ownership?**

ANSWER: Finding the balance between concluding compacts more rapidly while maintaining quality and MCC's unique country-driven approach to development is our greatest challenge. We maintain that it is critical to our approach that the eligible countries drive this process. One of the basic underpinnings of MCC is that it is in the long-term interest of eligible countries to develop the capacity to design these projects and to engage in a broad consultative process. This is a new experience for many governments and we believe it has enormous potential. Our partner countries who have successfully made it through to Compact signing agree that this takes time but is critical to their development and MCC's success.

There are a number of steps we are taking to accelerate the process. Lessons learned on both sides will shape our approach going forward. We have held a number of workshops with our partner countries to share the lessons and get their feedback. We are using 609(g) funding for technical aspects of compact development such as to support feasibility studies, the collection of data, environmental impact assessments, preliminary engineering and similar activities and we are willing to consider country requests for needed areas of support, as defined in our 609(g) policy posted on our website. We continue to discuss areas of potential funding with our MCC partners and may consider whether "facilitators" could help accelerate the process while preserving ownership. We are also considering additional areas where the use of 609(g) funding can be expanded.

*Environmental Protections. The Millennium Challenge Act of 2003 strongly encourages the Board of Directors of the MCC to select countries for MCA eligibility based upon numerous factors, including a country's demonstrated commitment to promoting "the sustainable management of natural resources" (Section 607(b)(2)(B)). The Act also prohibits the MCC from providing assistance under an MCA Compact to any project that "is likely to cause a significant environmental, health, or safety hazard" (Section 605(e) (3)).*

**28) What measures has the MCC implemented to identify and integrate into the selection criteria an environmentally-based indicator? What progress has the task force, which is being led by Governor Christine Todd Whitman, made in this regard?**

ANSWER: MCC has launched a public process in search of such an indicator or index, seeking broad input from the academic community, public and private sector practitioners, and researchers at think tanks and non-governmental organizations. We kicked off this process in February at a public conference chaired by Governor Christine Todd Whitman. Most recently, we worked with the Brookings Institution to bring together on June 24<sup>th</sup>, 2005, leading experts on indicators, development and the environment, as well as policy makers who use data for decision-making, to discuss potential indicators and the process for submitting ideas to MCC. Governor Whitman explained to this community the critical factors for considering an indicator and how the Board could potentially use this indicator to make critical decisions about eligible countries. This event marked the official launch of a request for ideas for an indicator.

By making the sustainable management of natural resources an MCC policy indicator, MCC can raise the profile of environmental issues in developing countries and provide a powerful financial incentive for improving natural resource management policies and institutions. As an intermediate measure, MCC provides its Board of Directors with supplemental information to assess whether countries manage their natural resources in a sustainable manner. These include indicators such as percent of urban and rural population with access to improved sanitation and change in forest cover as an average annual percentage from 1990-2000.

**29) What assessments are being conducted on proposed Compacts with Honduras, Nicaragua Georgia, and Cape Verde, particularly for those that include large infrastructure and agribusiness components?**

ANSWER: MCC conducts extensive due diligence on all aspects of a country's proposal. As part of its staff, MCC has hired experts in various fields (infrastructure, agriculture, environment, financial sector, and fiscal accountability) to lead these efforts. MCC supplements these teams with additional technical experts through use of inter-agency agreements, personal services contractors, and private-sector firms.

MCC used this model in each of the countries mentioned. For instance, in addition to MCC's own resources, MCC procured the services of the U.S. Army Corp of Engineers (USACE) to assist us in assessing the infrastructure portions of the Nicaraguan and Honduran proposals. USACE has been working in these countries for years and has deep and broad knowledge of the engineering feasibility issues. Other examples include MCC using expertise from the Department of Agriculture when looking at watershed issues in Nicaragua or using a private-sector engineering firm when analyzing the port project in Cape Verde.

MCC's model is built around substantial due diligence of projects to gauge technical viability, costing issues, sustainability, and implementation and management capacity.

*MCC and USAID. One of the most contentious issues with regard to the MCA has been and continues to be its relationship with the United States Agency for International Development (USAID). Yesterday, in testimony before the House Appropriations Subcommittee on Foreign*



*Operations, USAD Administrator Natsios indicated that different elements of the Administration disagreed as to the continuing role of USAID in MCA countries.*

**30) What will be the role of USAID in delivering development and other foreign assistance in an eligible country that receives MCA assistance? Mr. Applegarth, what is your opinion of whether USAID missions should close their doors in MCA countries?**

MCC does not promote the retrenchment of any of USAID's missions. The level of USAID activities in a given country is a program decision for USAID to consider. We do, however, consider the level and mix of all donors within the recipient country as we evaluate a country's proposal, etc.

As you are aware, there are a number of different objectives for providing foreign assistance: supporting U.S. geo-strategic interests, providing humanitarian relief, promoting development, strengthening fragile states, and mitigating global and transitional problems. Each of the programs mentioned in the question plays an important part in the implementation of our national security strategy. In addition to our bilateral programs, our alliances and participation in multilateral institutions play a fundamental role in realization of our common development goals. MCC is unique in that it only has one goal -- to reduce poverty through economic growth. It uses the lessons learned from development on how to use foreign assistance to catalyze poverty reduction and economic growth.

The State Department and its embassies integrate the Millennium Challenge Account (MCA) into their country plans. This process began even before the MCA was formally established. As former Secretary of State Powell wrote to State Department staff in June 2003, "The MCA will provide a natural bridge to discuss broader economic and political reform issues with developing countries. I am looking to all of you, not just our economic officers and USAID staff, to help poor countries view the MCA as a chance to take the hard but needed steps for lasting progress." "The MCA will give us a powerful new tool." (State Magazine, June 2003)

Reflecting this sentiment, the U.S. embassies, including USAID missions when present, provide MCC information and analysis on the country and its capabilities and support MCC in its relations with the host government. In addition, in partnership with MCC, USAID will take the lead in overseeing implementation of the Threshold Program. To be a proper incentive, MCC funding should be additional to existing funds from the U.S. Of course MCC's objective is to promote poverty reduction and growth so that a country graduates from dependency on foreign aid. However, this will not occur instantaneously, and is part of a long term process. The principle of MCA funds being additional is not a guarantee against changes or reductions in other US aid programs in a country; however I would expect most programs and USAID to maintain a presence in most or all of the MCA countries where it currently operates.

Because of its unique selection criteria, the MCA is useful in encouraging reform and particularly helpful in achieving the following goals of the State Department and USAID Strategic Plan:

- Strengthen world economic growth, development, and stability

- Advance the growth of democracy and good governance
- Improve health, education, environment, and other conditions for the global population.

*Women, Girls, and Other Gender Considerations. Research has shown that there is a strong positive correlation between increased women's participation in socio-economic activity and development effectiveness. In response to pressure from Congress and the NGO community, the MCC modified its eligibility criteria to include a gender-specific indicator the completion rates of girls from primary schools. Yet, concept papers and proposals from MCA-eligible countries as well as the Madagascar Compact do not adequately address how women will participate in, and benefit from, the proposed programs.*

**31) What structures and processes have been implemented to ensure that gender-based assessments will be factored into the selection process for program proposals? What are you doing to ensure that your staff has the technical capacity to evaluate proposals for, and provide technical assistance to, countries regarding the importance of women in development?**

ANSWER: We have on our staff technical experts who incorporate gender analysis into their work on agriculture, infrastructure, environmental/social impact issues, land tenure, financial sector, and in the monitoring and evaluation frameworks. Our country teams include individuals with development experience that have done this type of analysis, are sensitive to gender issues when evaluating program design.

As part of our proposal analysis, MCC staff consults with women and women's groups to form a judgment about whether the proposed programs will reach women. For example, with regard to agricultural programs in Africa, where a significant share of agricultural work is performed by women, MCC's agricultural specialists work with stakeholders in each country to identify the particular status and role of women and how to design interventions that can improve their situation. Understanding a woman's role in agriculture can improve technologies to make women's work easier and more productive, whether it involves packaging inputs in volumes that can be handled more easily by women, assisting with water supply, energy for cooking, transportation to markets, etc. Supporting productivity enhancements in those crops important to women, whether for household consumption or marketing, is an important part of program design that MCC considers.

We have established a gender working group among MCC staff to examine these issues. We are in the process of recruiting staff with gender expertise to analyze the compacts generally, as we think this is an important responsibility. We have also brought in a series of experts to talk to our staff about gender analysis.

**32) How does the MCC encourage potential recipient countries to develop and implement policies that benefit women?**

ANSWER: MCC's focus on gender starts in the selection process. MCC's selection indicators have a gender component in the determination of eligibility. As our indicator on educational attainment, we use girls' primary completion rate. There are indications that girls' primary completion rate is a good indicator for a growth-promoting education policy, but this is also a signal to candidate countries of the importance we place on gender.

In compact development, our approach starts with the consultative process and continues through to monitoring and evaluation. In our discussions with countries and in our written guidance, MCC stresses the importance of consultations with women and women's groups to understand their challenges. We specifically examine the extent to which women participate in consultations, including during program and project design. We also ask our staff to evaluate the extent to which their input of women is taken into account and shapes the program design.

On the program itself, MCC staff consults with women and women's groups to form a judgment about whether the programs will reach women. For example, with regard to agricultural programs in Africa, where a significant share of agricultural work is performed by women, MCC's agricultural specialists work with stakeholders in each country to design interventions that can improve their situation. Understanding a woman's role in agriculture can help to improve technologies to make women more productive, whether it involves packaging inputs in volumes that can be handled more easily by women, assisting with water supply, energy for cooking, transportation to markets, etc. Supporting productivity enhancements in crops is important to women, whether for household consumption or marketing, and is an important part of program design that MCC explores with the partner country.

Our monitoring and evaluation indicators are, to the extent practicable, disaggregated by gender, age and income level, so that we can see whether impacts are reaching the intended beneficiaries and are the impacts different across these groups.

