



From Innovation to Impact: Next Steps for the Millennium Challenge Corporation

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Introduction

As the Obama administration takes office this month, it will be looking at ways to meet its goal of elevating development as a third pillar of U.S. foreign and national security policy, alongside defense and diplomacy. Today, there is widespread agreement that smart U.S. foreign policy requires not just military strength but also enhanced diplomacy, strong economic policy, and new approaches to global development.

One of the most promising tools for this smart policy is the Millennium Challenge Corporation (MCC). Launched five years ago, the MCC's innovative approach to foreign assistance complements other key U.S. development programs, including USAID, PEPFAR, and the Multilateral Development Banks. The MCC has made considerable progress since its inception, and is showing great potential toward fulfilling its mission of supporting poverty reduction through sustainable economic growth. Nevertheless, the full potential of the MCC has yet to be realized. To become an effective instrument to leverage U.S. "smart power," the MCC will need to achieve greater effectiveness, clarity of purpose, and integration with the broader U.S. foreign assistance framework.

The time is ripe for bold action. The Congress and the new administration are exploring options for modernizing, consolidating and revitalizing the U.S. foreign assistance network. A strengthened MCC should be part and parcel of this effort. With the initial start-up phase of the MCC nearing completion, the organization is transitioning into a pivotal second phase of its existence. The primary challenge facing the next CEO during this second phase is to demonstrate clear development impact on the ground. Fundamentally, success will be contingent upon the MCC model proving to be not only innovative and feasible, but also effective in achieving poverty reduction through sustainable economic growth. The next few years will show whether the best-practice standards implemented by the MCC actually translate into better results on the ground, and whether the incentive-based eligibility structure truly inspires *and sustains* policy reform in recipient countries. Such success will be critical to the MCC's ability to build a broad coalition of support and to sustain Congressional support into the future.

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Looking Back: Success in the Start-up Phase

The MCC was built around a number of key innovations that are based on lessons learned over time by other donors, many of which are included in the Paris Declaration on Aid Effectiveness. As the new administration tackles its pledge to strengthen U.S. foreign assistance programs, these components of the MCC model are worth maintaining, if not replicating, across other foreign assistance programs.²

- ***Singular mission:*** The MCC’s mandate is to support poverty reduction through sustained economic growth in a select group of poor but well-governed countries. This institutional focus clarifies objectives and simplifies investment selection and impact assessment.
- ***Policies matter:*** The MCC selects countries that perform well in policy areas that are widely regarded as central to fostering economic growth, poverty reduction, and development. It supports countries with a strong record of ruling democratically, investing in health and education, and implementing sensible economic policies. The transparent, indicators-based selection process has proven to be a powerful incentive—dubbed the “MCC effect”—for reform in candidate countries and has been an important aspect of the early impact of the MCC.³
- ***Country ownership:*** Once eligible, countries themselves lead the investment selection process—including conducting growth constraints analysis and public consultation—and program implementation. To date, most countries have prioritized rural/agricultural development and infrastructure programs, critical growth and poverty-reduction investments that have been underfunded by traditional donors over the past decade. Several of the more recent compacts have included important health and education components.
- ***Results matter:*** Investments are chosen based on their ability to yield economic returns and show progress on key monitoring and evaluation indicators. Often, independent impact evaluations are included in the project design to measure impact upon completion.
- ***Operational flexibilities:*** The MCC model embodies several key international best practice development effectiveness principles:
 - ***Country-led, not DC-directed:*** MCC programs finance the highest-priority investments as determined by people in the country, not based on sector earmarks determined in Washington.
 - ***Predictable finance:*** MCC commits the entirety of funding for its five-year compacts upfront (so-called “no-year” funding), allowing countries to predict and sync investments in long-term development projects with their own budget and planning cycles.

² For another recent analysis of the MCC, see Lex Rieffel and James W. Fox, “The Millennium Challenge Corporation: An Opportunity for the Next President,” Brookings Institution, December 2008, found at: http://www.brookings.edu/papers/2008/12_mcc_rieffel.aspx

³ See Millennium Challenge Corporation, “The ‘MCC Effect’: Creating Incentives for Policy Reform; Promoting an Environment for Poverty Reduction,” November 2008 (<http://www.mcc.gov/documents/mcc-102108-mcceffect.pdf>) and Millennium Challenge Corporation, “Building Public Integrity through Positive Incentives: MCC’s Role in the Fight against Corruption,” 2005 (<http://www.mcc.gov/documents/mcc-workingpaper-corruption.pdf>).

- Merit-based procurement: Goods and services are procured through global competitive bidding, enabling best value for money and enhancing local business development.
- **Public-private governance structure**: The MCC board composition of five heads of government agencies and four members of the private sector is a key design feature of the MCC. In many respects it puts into practice a whole-of-government approach lacking from other U.S. foreign assistance programs, ensures input from non-government perspectives, enhances transparency and credibility, and helps reduce (although not eliminate) the possibility of MCC funds being used for short-term political goals that may not be consistent with its long-term mission. It balances the need for a close collaboration with the Secretary of State (who chairs the board) with the need for some independence to pursue its long-term objectives. In sum, the composition of the board helps to align MCC investments with foreign policy goals, coordinate development strategies and programs across agencies, and incorporate practices from the best of the private sector.

In its first five years, the MCC has established these key principles of innovation in its model and has put into place the institutional structures and processes to implement this vision. Twenty-six countries are currently eligible to apply for MCC compact finance, and 13 additional countries are currently eligible for threshold program finance. To date, the MCC has signed compacts with 18 countries totaling \$6.3 billion over five years, averaging about \$350 million per country. Reflecting the country-driven prioritization of funds, over 70 percent of MCC investments are in infrastructure and agricultural development. In addition, it has awarded \$440 million in threshold programs to 19 countries (most of which are administered by USAID). This entire portfolio is managed by a staff in Washington limited to 300 people.

While the MCC's innovations and initial investments are beginning to demonstrate some preliminary results, at this stage it is still too early to see the large-scale development outcomes on the ground envisaged by the MCC. One key challenge that continues to face the MCC is that actual disbursements of financing and the progress towards measurable results on the ground have been slower than many originally had forecast. Through September 2008, cumulative MCC program disbursements totaled \$658.7 million for FY2004-2008. Over half of this amount was disbursed in FY2008, indicating an acceleration of disbursements.⁴ To some extent, initial expectations were unrealistically high, both because the MCC was a start-up that needed to put new systems into place and because investments in infrastructure (in particular) take time, especially if they incorporate proper oversight and ensure quality. Moreover, disbursements alone are not a good indicator of success, and there is some risk in focusing too much on disbursement numbers (in fact, overly-rapid disbursements can also be problematic, as they can be indicative of inadequate oversight and quality control).

However, to some extent the pace is due to processes and procedures that have at times slowed progress more than necessary. Over the past year, the MCC has taken concerted steps to streamline procedures, including introducing standard bidding documents for procurement, reducing restrictions and approval requirements, increasing training for accountable entity staff, and devolving more decisions to the field. All of these steps save time, increase efficiency of operations and support the principle of country ownership. And further efforts to streamline

⁴ Millennium Challenge Corporation, "Quarterly Results Report: Quarter 4, Fiscal Year 2008."

procedures while maintaining control on quality should continue. However, deeper procedural efficiency will not in and of itself lead to a big leap in disbursement rates or greatly accelerate program results. This is because, for the most part, project timelines are determined by the pace of environmental and social impact work, technical studies, and procurement steps. In the context of pressure to accelerate implementation, it is important that the MCC strike the right balance between seeking efficiencies and adhering to standards of fiduciary and technical oversight, protecting environmental and social safeguard measures, and ensuring that procurements are competitive, transparent and clean.

Of particular note in its first phase, and continuing into the MCC's future, is the impact of Congressional budget appropriations. The MCC's FY2008 budget was \$1.5 billion, far below the \$3 billion request, and slightly lower than the previous year's budget (\$1.75 billion). The FY09 Continuing Resolution retains funding at FY08 levels, although this could change when the budget is finalized. The MCC budget has been under increased scrutiny in recent years, and this pressure is unlikely to subside with mounting demands on the overall budget. The Senate proposed only \$254 million for FY09 and most budget trackers predict a "split the difference" outcome which would result in an approximate \$900 million FY09 budget for the MCC. This is an issue of major concern, as this level of funding would significantly weaken the MCC's ability to provide funding for newly eligible countries (Colombia, Indonesia, and Zambia), and could undermine the MCC incentive effect for countries to strengthen their policies in order to become eligible in the future.

Looking Ahead: Success in Phase Two

The overarching goal for the MCC for the next phase of its operations should be *to show demonstrable progress in its mission to reduce poverty through the promotion of sustainable economic growth in its partner countries*. The overriding focus of the MCC going forward should be implementing effective compacts that achieve this goal as quickly and efficiently as possible, including in its country selection, program design, threshold program, and organizational procedures and structure. Within this overall goal, five key objectives stand out:

1. ***Achieving robust development outcomes on the ground.*** Whereas the initial focus of the MCC was on establishing a *model* that is innovative, the imperative moving forward is to demonstrate conclusively that the model actually delivers *results*. In the next few years, the MCC, Congress, the public, and citizens of recipient countries must begin to see some initial project components reaching completion; observe tangible impacts on economic activity, job creation, and poverty reduction; and believe that money has been well spent. This will require, among other things, assuring programs (existing and new) are of high quality with significant rates of returns on investments.
2. ***Accelerating the speed of compact implementation, while maintaining quality.*** While some criticism of the pace of implementation of MCC activities is unwarranted, the MCC should aim to further accelerate the implementation process. There are several steps outlined below that the MCC can take (some on its own, and some with the support of Congress) to speed the process of implementation and accelerate the timeline to achieving results, while still maintaining effective

oversight and quality. Enhancing country selectivity through competition in the compact design stage, including with compact design and capacity building grants, will be a key component.

3. *Creating the foundation for sustained development results over time.* For the MCC to be truly effective, it must contribute to building capacity, institutions, and systems in recipient countries over time that can continue to deliver development results after the MCC is gone. The MCC's insistence on country ownership and wide participation by civil society and the private sector in partner countries is critical to this task. So too is establishing systems and procedures that build and strengthen government institutions, policies, and systems wherever practicable.

4. *Building a broad coalition of support.* The MCC must work closely with Congress, the business community, development organizations, and the public both at home and abroad to ensure that its mission and importance in U.S. global engagement is fully understood and appreciated. This support will be crucial to secure the future of the MCC model over the long term and adequate funding levels in the near term. Building such support will require clear demonstration of effectiveness and results, coupled with a comprehensive communications and outreach strategy.

5. *Integrating the MCC effectively into the broader (and changing) landscape of U.S. foreign assistance.* The structure of U.S. foreign assistance programs has changed markedly in recent years with the introduction of the MCC, PEPFAR, the so-called "F process," and the growing importance of other agencies such as the Department of Defense. The president-elect's campaign promised to modernize and elevate foreign assistance programs, but the precise direction of its strategy has not yet been determined. The MCC must forge ahead with its mission while effectively integrating its work within the broader system of U.S. foreign assistance.

The new administration faces two key challenges in achieving these objectives. First, while all of these objectives are aimed at achieving the MCC's overall mission of reducing poverty through sustainable economic growth, at times there are inherent tensions and tradeoffs between them. For example, the desire for speed sometimes conflicts with the need for country ownership and building local capacity to implement projects, both of which take time and require patience. Moreover, country ownership is not an absolute, insofar as countries cannot just do whatever they want. The desire for ownership and commitment by the host country must be balanced with the need for meeting basic standards on returns on investment and proper fiduciary oversight.

Second, the MCC faces a significant budget constraint in meeting these objectives. As pressure on the budget grows, the MCC may be forced either to reduce the number of countries that it names as eligible or to reduce the size of each compact. Either choice could undermine the basic principles of the MCC. If the MCC retains the same selection process but chooses fewer countries, it could risk undermining the "MCC effect" if countries perceive that they may not be selected even if they do the hard work necessary to pass the indicators test. If instead the MCC approves smaller compacts, it will undermine its ability to foster transformative change that can reduce poverty through sustained economic growth, with weaker results on the ground. The MCC's ability to show results over time depends to a large degree on its budget, while at the same time its ability to gain support for its budget depends on its ability to show strong results on the ground.

Securing Its Future: Key Reforms to Enhance Effectiveness

As the new leadership team takes the helm, the MCC's progress to date provides a solid foundation for future success. With decisive action in several key areas, the MCC can realize its full potential as an innovative development finance organization that supports measurable development progress on the ground. The following sections outline our recommendations to the new team.

1. Establish greater selectivity and stronger quality standards at every stage. The MCC has gone well beyond other donor organizations in terms of introducing country selectivity, economic rates of return analysis, constraints analysis, and monitoring and evaluation procedures into its investment decisions and implementation processes. Whereas other donors talk extensively about these issues, the MCC has actually introduced them, and it deserves much credit for being on the cutting edge of these issues. Nevertheless, it will have to sharpen its focus and adjust its model in the next phase, partly for budgetary reasons, and partly for quality control reasons to ensure strong results on the ground. The reality is that the MCC model of large, transformative compacts is unlikely to be sustainable over the long term with 26 compact-eligible and 13 additional threshold-eligible countries, and a budget of less than \$2 billion per year. As a result, the MCC will need to institute greater competition and, hence, greater selectivity at the country candidate stage, the country selection stage, and the compact design stage. It must be willing to select fewer new countries going forward, reject compact proposals when the returns on poverty reduction and income generation are not commensurate with the investments, and terminate country eligibility and compact funding when countries do not live up to their commitments. A thorough review of the existing portfolio should also be considered by the new leadership team to both streamline implementation and weed-out poor performing or poor return projects, and either reallocate the resources to performing components or experiment with alternative financing options (see below). These challenges will not be easy, but they are central to the long-term success of the organization.

2. Seek authority for concurrent and longer compacts: To achieve the dual objectives of greater speed and effectiveness, one of the most important reforms that the MCC should consider is the introduction of concurrent compacts. The MCC's authorizing legislation presently limits a single compact per eligible country. Since compacts can last up to five years countries are, in effect, allowed only one compact every five years. This structure creates a number of problems. Most importantly, the incentives push for large, complex, multi-faceted compacts. Because of their sheer size and complexity, the process of compact design, impact analysis, due diligence, and other preparatory steps is long and cumbersome. And because no part of the compact can go forward until the preparatory work on the least developed (and often most complex) component is completed, implementation is delayed. Moreover, once a compact is signed, a country has little incentive to maintain strong performance on the MCC eligibility indicators, since passing has only symbolic value when new compacts are not possible.

The MCC legislation should be amended to allow for smaller, more frequent, concurrent compacts. Specifically, it would retain the existing concept of a five-year (or more) umbrella strategy but would divide and sequence smaller subcomponents, implemented through concurrent compacts, that would be handled more strategically and easily on their own.

Therefore, countries could have compacts at any year within the umbrella strategy so long as they are selected for eligibility. For example, instead of signing one large \$400 million compact covering everything for a five-year period, a country could initiate several separate compacts totaling \$400 million but staged to tackle divisible components in a way that allows appropriate staging and durations of activities based on their preparedness and sequencing to meet the overall goals of the compact. For example, a first subcompact could include strengthening procurement and contract management systems and capacity, establishing a roads maintenance fund, and initiating a land titling project. The second would tackle the next set of components (e.g., roads and agricultural extension training). The third would tackle the next sequenced components, and so on. Critically, each of the individual concurrent compacts could continue to last for up to five (or more) years, and the very strong feature of fully appropriating up front the funds for the entirety of each individual compact should be retained.

Importantly, countries would have to be making sufficient progress on existing compacts and meet the performance indicators to be declared eligible by the MCC each year. If a country was not declared as eligible, previous compacts could continue toward completion (so long as they were on track), but a new compact would not be initiated until a country was deemed eligible again. Thus, this structure would provide a powerful incentive for countries to maintain strong performance on the eligibility indicators.

Allowing for concurrent compacts within an overarching country-designed growth and poverty reduction umbrella strategy would:

- Allow MCC to enter into smaller and more manageable compacts, which would significantly speed the implementation process and accelerate the time frame for beneficiaries to see real results on the ground;
- Act as a carrot to motivate further policy reforms and encourage heightened implementation performance;
- Reduce inefficiencies and save taxpayer dollars because the domestic systems to implement the programs will be set up for the first compact, making subsequent compacts easier;
- Reduce (potentially) the amount of upfront obligations per country, as funding only the components ready to roll out in the fiscal year would be requested that year; and,
- Help to effectively transition (without gaps) current compacts that merit a second round of engagement (six countries will complete their first compacts by FY10 or FY11).

In addition, the MCC should consider, in some cases, approving compacts with durations longer than five years. Having defined time frames for MCC compacts is important, but in many cases it is impossible to finish large poverty reduction projects within the mandated five-year period, particularly with the MCC's emphasis on recipient-led implementation (it is often impossible to complete these projects in the rich world in five years, much less in MCC countries).

3. Focus exclusively on low-income countries: With budgetary pressures likely to grow more intense in coming years, the MCC must allocate each additional dollar where it is most likely to achieve its over-arching goal of reducing poverty through sustainable growth. The MCC legislation permits (but does not mandate) the MCC to allocate up to 25 percent of its funding for

compacts in lower-middle-income countries (LMICs). Currently, of 26 total compact-eligible countries, eight are LMICs, including four that were originally LICs that graduated to LMIC status by virtue of increasing per-capita income in recent years.

We recommend that the MCC focus its funding on low-income countries (LICs) and phase out its programs in LMICs, for the following three reasons:

- ***Need.*** LICs have much lower average incomes, higher poverty rates, lower literacy rates, and higher infant mortality rates than LMICs. Poverty rates in compact-eligible LICs (measured against a poverty line of \$1.25/day) average about 42 percent, while in compact-eligible LMICs they average about 17 percent, and some are much lower. In Jordan, for example, the poverty headcount index (using a poverty line of \$1.25 in income per person per day) is about one-third of one percent, virtually assuring that an MCC compact will have no impact on extreme poverty in that country.
- ***Access to other sources of financing.*** LMICs typically have access to much greater amounts of private financing than LICs. On average the LMICs have higher private saving rates, larger budget revenues, and larger amounts of foreign investment than LICs.
- ***Scope for greater impact.*** While it is sometimes asserted that LMICs are better bets for growth and poverty reduction, in fact LIC compact-eligible countries have recorded faster economic growth and larger reductions in poverty in recent years on average than compact-eligible LMICs, so (all else being equal) an investment on the margin in the LICs would tend to have greater impact than an investment in LMICs.

Phasing out programs in LMICs would create a slight dilemma for countries that graduate from LICs to LMIC status. On the one hand, it would not make sense to cut off these countries abruptly, but neither would it make sense to continue to provide them with compacts until they graduate from LMIC status. A sensible solution would be to phase them out over time. One option would be a guideline that once a country moves to LMIC status, it would be eligible for at most one additional five-year compact before graduation (so long as it continues to pass the indicators and perform on its existing compact). This option is particularly attractive should the MCC move to smaller concurrent compacts.

4. *Recognize the Indicators for What They Are and What They Aren't:* The MCC's indicator-based selection process is one of the fundamental innovations of the MCC model. It has allowed the MCC to identify countries committed to sound development policies and has been viewed as being, by and large, objective and transparent, based primarily on policy performance and not politics. But it must be recognized that while the indicators that underlie the selection process are credible *proxies* for sound policies, they are imperfect measures for capturing policy performance in any given year with full precision. That does not mean they should be dropped or ignored, since they are far better than no indicators at all, but they should be interpreted smartly and carefully.

The indicators are imperfectly correlated with policy performance in any given year for three primary reasons. First, time lags can delay policy reforms from being reflected in annual indicator performance. Second, periodic changes in the underlying data sources or the indicators themselves can result in fluctuations in indicator performance that are entirely unrelated to a

country's policy performance. Third, some areas of performance are inherently difficult to measure, such as corruption. As a result, it is sometimes hard to distinguish between fluctuations in the data and real changes in performance. Countries that are maintaining satisfactory policy performance may fail the indicators in any given year while, on the other hand, a sharp deterioration in the policy environment of another country may not be reflected in that country's indicator performance that year. It is also important to recognize that it is difficult for countries to meet MCC's eligibility criteria and even more difficult to sustain passing scores over time.

It is thus imperative that indicator performance be interpreted carefully and judiciously, with calls to apply a rigid "on-off switch" linked to the annual indicators assessment resisted. (Prudent judgment in how to view and apply the indicators test will become even more important moving forward if the MCC receives authority for concurrent compacts, as countries would presumably need to pass each year to be eligible for each subsequent concurrent compact.) That said, the MCC should consider ways to make clearer the relationship between indicator performance and maintained eligibility. For example, it could enforce a guideline in which any country that fails the indicators test three years in a row loses its eligibility, as we have recommended in the past. This "three strikes and you're out" policy would allow time for countries to take appropriate policy action if indicator scores begin to slip and for trends in the data to be adequately captured. Alternatively, the MCC could decide that unless there is major slippage, eligibility would hold for the five years of compact implementation. It could also consider adding an incentive to sustain performance, for example, a *cash bonus payment-for-progress award*, to countries that sustain passing scores over the entire five years of its compact. Of course, all options rely on the MCC enforcing its eligibility and program suspension and termination policy when necessary.

5. Reorient the threshold program: The principle focus of the MCC should be to implement effective compacts that deliver results on the ground. To date, the threshold program has not focused on preparing countries for *successful* compacts, but rather has focused exclusively on helping countries become *eligible* for compacts. As it is currently designed, the threshold program raises several concerns. First, it is divorced from the compact process, and thus does not help prepare countries for successful compacts. Second, by focusing on helping countries meet the eligibility criteria, it undermines the MCC principle that countries themselves should be responsible for achieving the eligibility criteria and makes the MCC (and USAID, which implements most threshold programs) partially responsible for indicator performance. Third, there are too many threshold countries. Greater selectivity is needed in the countries that are deemed eligible for the threshold program. Countries should demonstrate strong trends in improving the indicators that show them to be credibly close to passing in two to three years (such as Indonesia, Zambia, and Liberia) and the board should not use the threshold program for more political purposes (such as Kyrgyz Republic and Mauritania).

We recommend that threshold programs be made more selective and reoriented to focus on building the foundation for successful, speedy, and effective compacts. In reforming the threshold program, the MCC can choose whether to continue the substantive focus of the program on eligibility indicators, or to shift the focus exclusively to compact preparation. A third option would entail eliminating the program entirely, which, in the spirit of the MCC's approach, would fully restore accountability to the countries themselves to pass the indicators. Three possible options for reform of the threshold program include the following:

- Augment the existing threshold program to incorporate an added emphasis on compact preparedness. In so doing, the original focus of the threshold program on eligibility would remain intact. However, the program would be reformed to better prepare for the compact process and accelerate speed once countries achieve eligibility, by paving the way for the establishment of the accountable entity structure and for strengthened capacity for compact implementation.
- Revamp the threshold program to focus exclusively on preparing countries for compact implementation. Under this option, the threshold program would no longer focus on eligibility; rather, it would provide resources and capacity building to countries “close” to eligibility to prepare them early for compact implementation, and to ultimately reduce the time lag between eligibility and entry into force. This could look similar to an expanded 609g program, with the important distinction that these resources would be provided to a subset of countries *prior* to selection (hence, before an accountable entity was established). This option would require focusing on a smaller number of threshold countries that are clearly close to being declared fully eligible.
- Eliminate the threshold program entirely and concentrate full resources on compact success. In this option, the MCC would no longer dedicate resources to threshold countries beyond the assistance provided by the MCC’s Development Policy shop in helping countries understand and navigate the reforms that trigger changes in the indicators. Instead, the resources currently provided to the threshold program would be invested in the MCC’s main clients—fully eligible countries—through an expanded 609g program, with the dual objectives of achieving greater speed and improved implementation performance. The enlargement of the 609g program would enable the MCC to provide adequate staff time and increased financial investments to accountable entities in countries that have been selected, to strengthen fiduciary systems, provide extensive standardized training in contract management, procurement and monitoring and evaluation, and launch feasibility and due-diligence activities. This option would help restore the basic overarching principle of the MCC—that countries that do the right things by their people, *on their own*, as demonstrated through passing the policy indicators, will be rewarded with MCC eligibility.

6. Use alternative financing methods smartly: For all of its emphasis on innovation, the MCC has thus far been decidedly un-innovative in one key aspect of implementation: the provision of traditional project finance to central governments only. While this type of project finance through independent accountable entities can be useful in the short run for establishing strong financial oversight, in the long run it can undermine critical institutional development by diverting talent and time away from formal government institutions. We continue to recommend that the MCC should introduce financing of compact activities through the recipient government’s budget on a pilot basis in a subset of MCC countries with the best financial oversight and performance systems.⁵ This should not be confused with generalized budget

⁵ See Herrling and Radelet (2006), “Should the MCC Provide Financing through Recipient Countries’ Budgets? An Issues and Options Paper,” The Center for Global Development, August 2006, Available at: <http://www.cgdev.org/content/publications/detail/14130/>.

support. The substantive scope of MCC activities would not be changed, nor would the performance and impact indicators used to judge progress on MCC compacts, but the financing for these activities would go through the government's budget and use government financial systems in countries that meet basic financial management and fiduciary standards. The amount of financing through the budget could increase incrementally over time as the country continued to improve its fiduciary standards. The objective would be to help countries to strengthen their own financial management systems and budget procedures while balancing this goal with continued (and strict) insistence on results, attribution, and fiduciary controls. Overall, this approach makes particular sense for a subset of MCC countries with the best fiduciary standards, given that MCC eligible countries are already those countries with a demonstrated commitment to sound development policies and governance.

There are three main reasons the MCC should introduce incremental and limited financing through government budgets in a subset of MCC countries:

- First, such a system provides clear internal incentives for countries to improve their fiduciary systems to better manage their own development, since improvement on these standards would lead to more financing going through the budget.
- Second, it would help strengthen the recipient government's broader budget, evaluation, and supporting financial institutions, rather than weakening them.
- Third, the incremental approach would allow countries to build implementation and fiduciary capacity at the same time that donor confidence is being built.

Another possibility in certain circumstances would be for the MCC to sign compacts with regional or local governmental units of the country, a nongovernmental organization (that could provide sub-grants to other NGOs), or even a private entity.⁶ Compacts with sub-national governments could be used constructively by the MCC in countries with highly decentralized government (e.g., Indonesia) and, particularly, if concurrent compacts were allowed, tandem compacts with central government and nongovernmental entities could be powerful development and accountability mechanisms. Compacts could also include more direct financing for private sector activities, including enterprise funds, microfinance, or other mechanisms, so long as they were well-designed and -managed. In addition, the MCC should explore potential opportunities for co-financing with private sector entities, especially for certain infrastructure projects such as ports or power generation, which could lead to significant leveraging of MCC financing.⁷

7. *Strengthen outreach and communications:* While the preceding reforms will go a long way towards addressing issues around impact, speed and disbursement, a fundamental communications issue (particularly with Congress) remains. The new administration will need to work closely with Congress to ensure the results that the MCC has achieved to date are fully recognized; develop common objectives for the MCC and a set of shared expectations around

⁶ Current legislation would allow funding of these kinds of activities. See section 605(c) of the Millennium Challenge Act of 2003, found at: http://www.mcc.gov/about/reports/other/mcc_legislation.pdf

⁷ See Lex Rieffel and James W. Fox, "The Millennium Challenge Corporation: An Opportunity for the Next President," Brookings Institution, December 2008, found at: http://www.brookings.edu/papers/2008/12_mcc_rieffel.aspx

how MCC (or an MCC-like approach) would achieve those objectives (including a reasonable disbursement rate for doing so); and build alliances and champions on the Hill for the MCC approach. Central to this outreach will be bipartisan discussions around the centrality of country ownership to effective aid, including ideally its centrality to other components of U.S. foreign assistance where appropriate; the importance of upfront compact funding obligations; the crucial role of infrastructure investment in poverty reduction; the time frames and benefit cycles inherent to long-term infrastructure investment; and the importance of investments in sustainable economic growth to U.S. national security. While Congress must maintain its important policy and oversight role, improved (bi-partisan) communications and outreach should help to ensure adequate appropriations in years to come.

8. *Reorganize for success:* The current operations model of large, complex, projectized compacts in a growing number of countries, coupled with a cap of 300 staff at headquarters and the current organizational structure, is unlikely to be sustainable. The new leadership should build on the many operational and organizational positioning successes the recent past, but it will also need to focus on personnel and organizational restructuring, Congressional and interagency outreach, and defining the model based on budgetary realities and experience to date. There are several key issues the new team should examine and possibly consider:

- Merging the Compact Development and Compact Implementation departments into one department or moving to smaller, regional groups which manage country teams.
- Considering the transition of the Deputy CEO position into a COO-type position focused on organizational strengthening, streamlined operations, and enhanced implementation.
- Hiring more economists and development experts with field experience, particularly in management positions, to restore the founding principles of the MCC's focus on sound investments with demonstrated growth returns.
- Giving great authority to impact evaluation and economic analysis.
- Rightsizing the resident country missions and decentralizing some decision-making to the field. Getting staff on the ground as quickly as possible (facilitated by pre-compact capacity building in the accountable entity) and adding a staff member with fiduciary and/or monitoring and evaluation skills could yield efficiency and effectiveness gains while continuing to build capacity in the recipient country.
- Establishing regional offices of technical and functional support (monitoring and evaluation, procurement, agriculture, gender, etc.) that service the field rather than Washington-based expertise that must travel (these regional offices potentially could be shared with USAID).

9. *Integrate better into the broader and changing landscape of U.S. foreign assistance:* The new Obama administration is currently considering how best to address the broad issue of improving coordination of *the entirety* of U.S. foreign assistance programs, including the MCC, to achieve maximum impact against their various objectives. The Obama campaign platform called for an “elevated, empowered, consolidated, and streamlined U.S. development agency”—an approach that could spell significant changes for the MCC's structure. In practice, this could take the shape of the MCC being folded into either the existing USAID (which seems unlikely), or into a fundamentally rebuilt and restructured version of USAID that would allow for MCC flexibility and innovation. The timing of this approach matters hugely. Building up USAID to

be the eventual base for all U.S. foreign assistance is a respectable goal. Integration of the various external programs, however, should take place after that rebuilding to allow for effective absorption. Another option is for the MCC to be integrated more closely with the State Department, an option that would risk the MCC's development programs being subjected to diplomatic pressures and short-term needs. Critically, should any of these structural changes occur, the innovative aspects that define the MCC's unique model should be preserved, if not replicated, by other assistance programs.

Alternatively, the administration might choose to keep the MCC as a separate entity and either make no structural changes or co-appoint the USAID Administrator as CEO of MCC while maintaining the MCC board. If the Obama administration chooses to maintain the current institutional structure of the MCC, the MCC should take steps to better leverage the inter-governmental constitution of its board to strengthen policy coherence and coordination. In particular, greater focus should be placed on the board's strategic and coordination role, rather than on the details of specific projects and compacts.

Conclusion

Regardless of the specific shape that a broader restructuring might take, the task ahead for the MCC is clear: to achieve its core mission and show demonstrable progress toward poverty reduction and sustained economic growth in its partner countries. Doing so will require that the MCC forge ahead with a set of specific reforms aimed at accelerating speed and bolstering the effectiveness of compacts, while at the same time more effectively paving the way for sustained results well into the future. Successfully implementing these reforms is paramount not only to realizing the potential of the MCC but also to its viability as an adequately resourced program moving forward.