



**TESTIMONY BEFORE THE HOUSE COMMITTEE ON FOREIGN AFFAIRS  
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**THE MILLENNIUM CHALLENGE ACCOUNT IN AFRICA:  
PROMISES VS. PROGRESS**

**I. Introduction**

Chairman Payne and Ranking Member Smith, distinguished members of the subcommittee, I am honored that you have invited me to offer some perspectives on the promises and progress of the Millennium Challenge Account.

This month the Millennium Challenge Account is three and a half years old. Conceived and announced by President Bush in 2002, the MCA was formally established in January 2004. In my testimony today I will begin by reflecting upon the genesis of the MCA, what it has accomplished to date, how it fits into the broader context of US foreign assistance. I will then examine three common critiques of the MCA that I believe are off-base: that it selects the wrong countries, it focuses on the wrong substantive areas, and that it cannot spend the funds that have already been appropriated. I will then turn to three critiques that have more merit: that the pace of implementation has been too slow, that it should focus on low-income countries and not middle income countries, and that the restriction limiting countries to one five-year compact slows progress and adds to program complexity. I will conclude by reflecting on what more needs to be done to realize the MCC's potential for bringing hope and prosperity to the world's poorest well-governed countries, many of which are in Africa.

**II. The Historical Context: Strong Criticisms and Low Levels of Aid**

The design, promise, and progress of the MCA can only be fully understood in the context of broader debates about and reform efforts of US foreign assistance programs. After the end of the Cold War, US foreign assistance programs came under heavy criticism, and funding dropped sharply in the early 1990s before starting to rebound in 1998. Many of the criticism raised then continue to resonate today. US foreign assistance programs are a hodge-podge of uncoordinated initiatives from multiple institutions without a coherent guiding strategy. Much of our aid is wasted on countries with governments that are not serious about development and that cannot use it well. Our aid programs are often politicized and aimed at achieving short-term political goals rather

than long-term development. Aid programs are subject to heavy bureaucracy that ensures that some funds never get close to their intended recipients. Aid flows are heavily earmarked and subject to myriad directives, procedural rules, and restrictions that add significantly to administrative costs and slow the delivery process. Moreover, there is little accountability for achieving results. Monitoring and evaluation systems are weak and tend to focus on whether funds are spent where they were supposed to be, rather than whether programs achieved their intended objectives.

It is important to recognize that often these criticisms are overstated and miss the fact that many programs have been successful. US foreign assistance was central to supporting the Green Revolution that provided the foundation for Asia's economic miracle; for eliminating small pox and substantially reducing polio, river blindness, maternal mortality and childhood diarrheal diseases; for helping to secure peace in countries such as Liberia and Sierra Leone; and for supporting sustained economic growth in Korea, Taiwan, Botswana, and more recently Mozambique, Tanzania, Ghana, and several other countries. US foreign assistance deserves more credit than it usually receives. Nevertheless, there is little doubt, even among supporters, that US foreign assistance programs can be significantly strengthened.

Debates about foreign assistance began to change in the late 1990s and the early part of this decade. The combination of the events of September 11, 2001, widespread criticisms about the small size of US aid flows, and growing concern about global poverty, debt burdens, and diseases such as HIV/AIDS led to growing recognition of the importance of strong foreign assistance programs as part of our broader foreign policy and national security approach.

Nevertheless, the MCA was designed and introduced in response to the debates about and criticism of aid. In short, it was aimed at partially resolving the twin problems of both the small levels of US foreign assistance and the broad concerns about its lack of effectiveness.

### **III. The MCA Concept**

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

- Clearly focus assistance on promoting economic growth and poverty reduction, rather than supporting diplomatic and political partners or achieving other goals that can be supported with other programs. The sharper focus goals should help ensure that both recipient countries and the American public get better outcomes.
- Select a small number of recipient countries that have demonstrated a strong commitment to sound development policies, helping make aid funds more effective.
- Allow recipient countries to set priorities and design programs through a broad consultative process, engendering stronger commitment for success by recipients,

and ensuring that programs actually are aimed at meeting the most urgent local needs.

- Keep the bureaucracy to a minimum, avoiding the large administrative structure, heavy regulation, and overlapping congressional directives that bedevil other aid programs.
- Provide recipients with sums of money large enough to make a real difference on the ground and provide strong incentives for success.
- Hold recipients much more accountable for achieving results, including being willing to increase funding for successful programs, reduce it for weaker programs, and terminate funding if necessary.

These principles hold out the promise of making US foreign assistance much more effective in MCA countries. But it is important to recognize that the MCA is only part of what is necessary to make broader US foreign assistance more effective. The MCA cannot and should not be forced to substitute for other programs or achieve other objectives, such as providing assistance to countries that do not have a demonstrated record of commitment to strong development policies. It must be seen as part of a broader whole, working in tandem with other bilateral and multilateral programs aimed at achieving complementary goals.

From a broader perspective, looking back, it is now clear that the administration should have introduced the MCA as part of deeper reforms of our foreign assistance programs. It is now undertaking those reforms, only belatedly and still only partially, through the so-called “F process.” But even these reforms will not be sufficient to meet today’s challenges. To make our foreign assistance programs truly effective, more substantial reforms are necessary to bring all foreign assistance programs under one independent authority, re-write the foreign assistance act of 1961, and develop clear strategies and coordination mechanisms for our assistance programs. Part of that strategy would recognize the need for delivering aid programs in different ways across different developing countries, depending to a large extent on recipient countries’ capacity to deliver effective programs. But even in the context of these broader reforms, the need for a program like the MCA would clearly emerge to deliver significant amounts of assistance to poor but well governed countries that are committed to effective development programs.

#### **IV. Initial Progress to Date**

The MCA has made significant progress in several key areas. First, its country selection process has worked relatively well. The MCC, by and large, has selected countries based on the merits of their commitment to strong policies, and not on political criteria. Its methodology of selecting countries based on publicly available data generated by independent sources has provided credibility and generated interest among other donors. Most importantly, it has created a strong “MCC Effect” in which the requirement to pass specified quantitative indicators has created the incentives for potential recipients to more carefully track the data and introduce the policy changes needed to meet the

requirements. There are examples from all around the world of the incentive effect of the MCA selection process.

Second, the MCC has moved to the frontier of facilitating broad participation among government, non-government, civil society, and private sector representatives in determining priorities and designing projects and programs. Many aid agencies talk about a participatory approach, but the MCC has been on the forefront of actually making it happen. It is far ahead of any other US foreign assistance agency in facilitating broad participation among the public in its programs.

Third, much of the focus of its early efforts has been in Africa. If compacts with Lesotho and Mozambique are signed as planned in the coming months, 7 of 13 compacts will be with African countries, representing over 60 percent of all MCC funding. Of these amounts, 70 percent of funding in Africa will be aimed at agriculture, rural development, transportation, and other infrastructure. These areas fill huge unmet needs in these countries and are central to the process of economic growth and poverty reduction. Beyond the basic numbers, the “MCC Effect” has led to important policy changes in many countries, and the early stages of compact implementation has led to the creation of increased capacity for project oversight and management. While less progress has been achieved at this point than had been hoped for, these early steps provide an important foundation for continued progress in the coming years.

## **V. Addressing Off-base and On-target Critiques**

The conceptual model of the MCA has received widespread support. However, the way in which that concept has translated into implementation has received mixed reviews. Some of the concerns raised are valid, and others less so. In my testimony today I will review six frequently-cited concerns about the MCA, three of which I believe are off-base, and three of which I believe are more-or-less on target.

### **Three concerns about the MCA that are off-base:**

- 1. The MCA funds the wrong countries – it focuses on successful countries rather than those most in need.*

This criticism comes in two parts: that MCA countries are successful and do not need assistance, or that the MCA misses out on countries that most need development assistance. The idea that MCA countries do not need assistance is unfounded (with the exception of middle income countries, a subject I return to below. Most MCA countries have very low incomes, widespread poverty and a history of slow economic growth. What distinguishes these countries is a relatively recent move toward accountable governments with strong development policies. Countries such as Mozambique, Ghana, Senegal and Tanzania are not yet success stories, but their shift toward democracy and strong economic and social policies give them the *potential* for rapid growth. They therefore are exactly the right countries to which the US should focus substantial amounts of foreign assistance.

Others argue that the MCA misses the countries that are most in need. While I agree that there is an urgent need for US policy to address the needs of weak and fragile states – a category which covers the majority of the developing world – I believe it would be inappropriate for the MCC to provide funding for these countries, and that other programs are more appropriate channels for assistance. The MCA model relies heavily on mission and country selectivity, country ownership and providing recipient countries substantial flexibility in establishing priorities and designing programs. This approach would not be appropriate in countries with weaker, less accountable governments with weaker commitment to strong development policies.

The MCA was not created to displace existing US foreign assistance programs, notably those within USAID. It was created as a small, but innovative, model to test the idea that aid is more effective in well governed countries. The success of the MCA model rests in its ability to stay focused on one mission – poverty reduction through growth – and one set of countries – poor but well governed.

***2. The MCA funds the wrong substantive areas -- too much infrastructure, not enough social investments.***

There are two problems with this criticism. First and foremost, the MCC does not choose the areas of funding, the countries themselves do. One of the great strengths of the MCA is that it recognizes that policymakers and citizens in well-governed countries are the right people to decide the most important priorities to fight poverty in their own countries through a broad consultative process. There is something deeply unsettling about commentators in Washington questioning the results of this process and declaring that they know better than African policymakers what their greatest needs are for fighting poverty. I believe that in well-governed countries with a demonstrated commitment to development, it is appropriate for us to defer to the judgments of policymakers in these countries but hold them fully accountable for achieving results, including terminating funding for lack of progress.

Second, from an economic development point of view, there are good reasons why many countries are choosing to finance infrastructure projects. Rural roads and similar infrastructure projects are central to poverty reduction and the effective delivery of health and education services, but most other donors do not fund these initiatives. From the perspective of recipient country policymakers, they have several alternatives for funding health and education programs, but few donors for infrastructure. In many cases, policymakers see infrastructure as an essential component of spurring growth and reducing poverty and are thrilled to be able to seek funding for a sector that has been massively under-funded for years.

Across Africa investments in physical infrastructure are central to raising productivity, increasing rural incomes, fighting poverty and achieving long-term growth. Such investment is especially critical in rural areas for at least two reasons: first, because ample potential remains for raising rural productivity and employment, thereby

contributing significantly raising rural incomes, and, second, because rural areas are home to the majority of the poor in these countries. In particular, investments in rural infrastructure can lead to higher farm and non-farm productivity, employment and income opportunities, and increased availability of wage goods, thereby reducing poverty by raising income and consumption. Rural roads are also central for facilitating delivery of health and education services – without decent roads, people cannot get to clinics and schools.

In terms of need, there is a large infrastructure deficit in Africa, both in terms of access and quality, in all the sectors -- transport, energy, ICT and water. According to the African Development Bank, only 30 percent of Africans have access to reasonable transportation, compared to over 75 percent for other lower income countries. Access to water and sanitation is about 65 percent compared to 80 percent for other LICs; access to roads is 34 percent compared to 50 percent for other LICs, while the penetration rate for telecommunication is less than 13 percent compared to 40 percent in other LICs. This situation has contributed directly to Africa's low rates of economic growth, reduced share of world trade, lack of international competitiveness, and poor delivery of social services for the rural population.

### ***3. The MCA can't spend the money it already has.***

Today, almost 60 percent of the \$6 billion that has been *appropriated* for the MCA and available for compact and threshold funding has been committed. Critics of the MCA's ability to spend the money it already has focuses on the low disbursement rate -- as of May 2007, only \$70.8 million had been disbursed to compact and threshold programs, only a fraction of the amount appropriated.

However, this comparison is not an accurate reflection of unspent funds. The MCC's authorizing legislation requires that all of the funding requires for a five-year compact be appropriated and available at the time of compact signing. As a result, an apparent low disbursement rate is guaranteed, and appropriated funds will always be far larger than those actually disbursed in the early years of a compact.

Closer analysis reveals that because of the pipeline of new compacts scheduled to be signed in the coming months, the MCC is likely to commit the remainder of FY07 monies and could commit the majority of its \$3 billion FY08 request. Much of these funds would go to African countries that make up the bulk of the near-term pipeline.

From FY04 to FY07, over \$6 billion has been appropriated for the MCA, of which \$5.6 billion is available for compact and threshold funding. To date, \$3.3 billion has been committed to 11 compacts and 11 threshold programs to be disbursed over five years. Going forward the MCC expects to sign compacts totaling \$1.5 billion with Mozambique, Morocco, and Lesotho along with several new Threshold Programs before the end of 2007. And six to eight countries will be ready to sign compacts in 2008. the most likely (with proposed amounts in parentheses) are: Tanzania (\$799 million), Mongolia (\$322 million), Namibia (\$314 million), Burkina Faso (\$540 million), Senegal

(\$255 million) and Moldova. The compact pipeline, the ten percent set-aside for threshold program funding, and administrative costs associated with managing the MCC, show the MCC can use both the money it already has and most of the money it has requested.

Continued low appropriations by Congress put the program between a rock and a hard place. The biggest impact will be felt by the poorest countries, most of which will be African countries, who worked hard to gain MCA eligibility and could face the prospect of no funding available for them when their compacts are ready to sign. Flat-lined funds will force the MCC to choose between signing larger, transformational compacts with fewer countries or financing smaller compacts spread across the increasing number of eligible reforming countries, neither of which reflects the intended mandate and global understanding of the MCA.

Furthermore, neither option of fewer countries or smaller compacts is optimal for promoting the “MCC Effect,” which to date has been the major success story of the MCC. With limited funding, the result is worrisome: countries that make targeted policy changes to meet MCA indicators (either on their own or through the MCC’s Threshold Program) will ultimately not receive assistance at all because of unavailable resources or the reward for reform will be too small to create a strong incentive for countries to bother.

### **Three concerns about the MCA that have some validity**

#### ***1. The MCC isn’t delivering results as quickly as envisioned.***

The early MCC years were fairly typical of a start-up organization, with resources dedicated primarily to staffing, positioning the institution within the broader donor community and demonstrating to eligible countries that this was not “business as usual” aid. Start-up activities, coupled with allowing for full country ownership and ensuring thorough public consultation, inevitably (and justifiably) led to a relatively long period before actual program implementation could begin. While there were many flaws, communication weaknesses, and unnecessary delays, overall I think the MCC has done a credible job in terms of creating an entire new agency, staffing it, designing a transparent eligibility process, and educating countries on operational guidelines that, in many ways, would be novel to them.

That said, after three and a half years in operation, I believe we should be seeing more substantial progress on program implementation. Madagascar is two years into its four year compact, and Honduras and Cape Verde will soon reach the two year mark. Georgia, Nicaragua, and Vanuatu have had compacts in force for over one year. At this stage we should be seeing more evidence of tangible progress on the ground in these countries.

The MCC itself also expected to see more progress by this point. Examining its own disbursement projections made at the outset of each compact, actual disbursements under each of the eight compacts for which data are available are well less than half of what the

MCC originally projected by this date. In 3 compacts, actual disbursements are less than 15% of the original projection. Of course, disbursement rates should never be the only measure of progress. In this case, however, I believe they reflect both an overestimation of the ability of recipient countries to hit the ground running on a new concept, and an overly-bureaucratic modus operandi in the MCC.

In some cases, the problems and constraints lie with the recipients. Partner country capacity and institutional constraints are testing its ownership principle, and some countries are not holding up their end of the commitments. But some of the problem lies with the MCC itself, which in some ways has tied itself in knots with overly-bureaucratic approval and oversight policies that are bogging down operational progress and frustrating recipients. Every step of procurement, hiring, program design, and even translation of standard operating documents must be approved by Washington. This has caused delays, undermined ownership among MCA country programs, and reduced the authority of country-based MCC officials. Designing a cumbersome set of standard operating procedures has dragged down the first program year in many countries.

In some cases there is more progress than meets the eye, as the MCC has helped establish strong systems to engage broader communities to participate in decision-making, and it has helped develop country capacity to strengthen planning, financial management, reporting, and monitoring. But here the MCC has done little to capture and communicate the intangible achievements crucial to maintaining public support, although it must take care in communicating this progress to not appear to be making excuses for less progress in more visible areas.

The MCC needs to focus on strengthening these operational nuts and bolts so they become a solid foundation for (rather than an obstacle to) meeting its mission. Importantly, it needs to find a different approach to risk management and strike a better balance between its oversight and approval systems on the one hand, and the need for efficiency and forward progress on the other. It certainly should take steps to avoid misuse of funds, but there is significant scope for reducing the multi-tiered, onerous oversight procedures to allow for more rapid progress on the ground. One piece of this would be agreement by Congress that under certain circumstances the MCC can provide more of its funding through local government systems while demanding results and holding countries to task for achieving them.

At the end of the day, the single most important challenge for the MCC is to show results. Ultimately the success of the program will be judged on its ability to meet compact targets of economic growth and poverty reduction. This is the year that MCC must begin to show progress in building roads, developing agricultural systems, and other tangible results on the ground.

## ***2. The MCA should target its operations to the poorest countries***

There is an on-going debate about which countries the MCA should target -- low income vs. middle income. I believe the MCA should exclusively target low-income good-performing countries.

Beginning in FY 2006, the MCC, per its authorizing legislation, added a second group of candidate countries consisting of all so called “lower middle income” countries with per capita incomes between \$1,465 and \$3,035 that could receive up to 25% of appropriated funds. The inclusion of these countries has always been controversial and to date, five LMICs are eligible to receive MCA finance (although two were originally selected as low income countries). Two (Cape Verde and El Salvador) already have compacts and one (Morocco) will sign its compact end August. LMICs 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 begin to “graduate” from aid and move to private sector finance (for example, Morocco graduated from USAID funding several years ago). It is particularly important in a time of constrained budget resources for the MCC to concentrate on low-income countries, and to not commit funding to middle-income countries. There is an acute danger that within the next year or two, the MCC will be forced to restrict funding to low-income countries in order to make room for middle-income countries.

Some argue that many of these lower-middle income countries, even with access to private capital, have significant numbers of poor people that can effectively use MCC assistance. There is some truth to this argument, but it is true for almost every middle income country in the world, including countries such as China, Malaysia, Brazil, and Mexico, which clearly should not be eligible for MCC funding. The MCC must allocate its aid funds where they are most urgently needed among the well-governed countries, 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. The biggest poverty reduction bang for the MCA buck is not going to be had by providing grants to countries that are three times richer than the original lower income group. In the face of competing demands of less money and more eligible countries, the MCC should not commit funds to middle income countries.

***3. The overall effectiveness of MCA programs may be hampered by restrictions to single compacts of 5-year duration.***

The current legislation governing the MCC does not allow it to negotiate concurrent multiple compacts with a single country, and it caps compact length at five years. Both of these provisions should be revised (both require Congressional action). The current prohibition on concurrent compacts creates the incentive for partner countries to make compacts as big (and often complex) as possible. This has led to recent compacts reaching \$500 million with several in the pipeline pushing beyond this. Larger compacts, in and of themselves, are not a bad thing. Transformational growth and poverty reduction will require it.

However, this structure creates two problems. First, the original design becomes much more complicated and cumbersome, slowing forward progress. Countries feel that they have one bite at the apple, and want to put everything possible into their single five-year grant. Second, because of the complexity, countries face increased risks of not meeting compact goals within the five year limit.

The MCC would achieve faster progress and stronger results if eligible countries were able to negotiate at least two concurrent compacts, and perhaps one compact each year. It would be more manageable to have staggered, more focused compacts and the flexibility to have some be longer than five years (such as those with social investments that need more time to yield higher rates of return or major infrastructure investments that take longer to complete). This would encourage countries to better sequence interventions and reforms, develop management capacity, move more quickly in implementing smaller initial compacts, and reduce risks associated with enormous compacts. This arrangement could actually increase the resources available to countries over, say, a ten-year period, and would increase the chances of meeting more manageable and focused compact targets.

## **VI. Some Key Steps Going Forward**

Several steps will help speed the process of compact implementation and strengthen the MCC's ability to provide substantial financing for poor well-governed countries. First, the MCC must thoroughly examine and streamline its internal processes and procedures that are impeding progress on compact implementation. One of the MCC's founding principles was to reduce unnecessary bureaucracy, but it has fallen short of that goal, to a large extent as a result of procedures of its own making. I understand this is underway within the MCC and strongly support it.

Second, Congress should reaffirm its firm commitment to a strong MCA that rewards poor countries with strong governance and development policies with significant financing to meet their highest priority needs. The program needs to transition from being perceived as "Bush Administration initiative" to a "good US foreign aid program." The basic MCA concept continues to hold tremendous potential for supporting countries with the greatest need and strongest commitment to support economic growth and poverty reduction. All parties should resist the temptation to broaden either the objectives or the country targets of the MCC, as either would weaken its effectiveness. The MCC's operation must be seen as one part of a broader set of foreign assistance tools, not as a single tool that can meet all objectives.

Congress should also reaffirm the core principle that recipient countries are in the best position to determine the highest priorities for funding for their own countries, whether that be agriculture rural roads, or primary school education. The MCA is designed to be flexible enough to fund whatever countries determine as their highest priority through a participatory approach, and we should all resist the temptation to determine sector allocations in Washington. In the same vein, and in the spirit of building local

institutional and fiduciary capacity, Congress should allow the MCC to provide a proportion of its funding through recipient country systems and budgets.

Third, the MCC Board, together with Congress, should focus MCC resources on low-income countries, and not make further commitments in middle income countries. Although middle income countries have legitimate financing needs, the biggest needs are in low income countries. In a world of limited financial resources, the MCC should allocate its grants to countries with the greatest needs that can use it well – poor, well-governed countries.

Fourth, Congress should allow the MCC to negotiate concurrent compacts in eligible countries. Allowing multiple compacts will lead to smaller, easier compacts, faster implementation, and greater probability of meeting key objectives.