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US Senate Committee on Foreign Relations Hearing on the Millennium Challenge Corporation: Lessons Learned after a Decade and Outlook for the Future

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Chairman Corker, Ranking Member Cardin, and members of the Committee, thank you for the opportunity to testify on the Millennium Challenge Corporation, a small but critical agency when it comes to US efforts to reduce poverty and promote economic growth abroad. I am honored to be here and very pleased the Committee is holding this hearing.

My name is Nancy Birdsall and I am the president of the Center for Global Development, an independent, non-partisan think tank headquartered here in Washington, DC. CGD conducts research and produces analytical outputs aimed at improving the policies and actions of rich countries, including the United States, that affect developing countries.

The Center has been closely watching MCC from the agency's inception. And since MCC celebrated its tenth year anniversary just last year, this seems a fitting moment to reflect on its record and consider its future.

MCC was a bold experiment when it was created by President George W. Bush in 2004. The concept was simple: channel US taxpayer money to poor countries that have responsible governments and sensible policies—those that encourage private sector activity, invest in schooling and health, fight corruption, and support democratic rights. This is consistent with American values and foreign policy objectives. Evidence suggests that these are the countries where foreign aid is most likely to make a difference by encouraging the policy changes that support long-run, sustained, poverty-reducing growth.

MCC's approach to delivering foreign assistance has set a standard for aid agencies around the world. It uses evidence to guide decision making; it focuses on achieving and measuring results, evaluating the vast majority of its programs; it gives partner countries the lead role in identifying and implementing its investments; and, overarching all this, it is among the most transparent donors worldwide. In quantitative assessments of the efficiency and effectiveness of more than 100 global aid agencies conducted by the Center of Global Development with the Brookings Institution, MCC consistently scores near the top of aid agencies worldwide on a set of aid effectiveness measures.[2]

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[1] Biography and CV: http://www.cgdev.org/expert/nancy-birdsall.
[2] Nancy Birdsall and Homi Kharas. *The Quality of Official Development Assistance (QuODA).* Washington, DC: Brookings Institution and Center for Global Development, 2014.

Today, I will focus on two areas where congressional action is needed to allow MCC to build on its strong record of success and two areas where continued support from Congress will help the agency deliver even more development impact. I will close with a plea for Congress to help other US agencies apply lessons learned from the MCC.

(1) Regional Compacts

Congress should authorize concurrent compact authority, and encourage MCC to pursue a regional pilot project with separate and additional funds above its country-based compact funds. Since regional projects bring an extra set of challenges, I recommend the agency start with a single pilot project accompanied by an independent review.

MCC has a strong record with road and power projects in bilateral compacts, but in regions like Sub-Saharan Africa with many small economies and highly fragmented markets, some of the highest-return, growth-spurring investments only result from facilitating regional connections. In the US context, for example, the Eisenhower Interstate Highway System was a federal initiative that linked people and markets across states—which no single state could have managed or would have financed.

To date, MCC has not been able to help eligible countries benefit from these kinds of returns because neighboring countries are rarely at the same stage of compact development at the same time; one country often has a compact underway by the time its neighbor is eligible. Concurrent compact authority (making countries eligible for a regional compact concurrent with a country compact covering some or all of the same period) offers a relatively simple fix to this shortcoming in the current MCC mandate.

Lack of this authority has impeded MCC's ability to encourage the necessary and often complicated negotiations between or among countries that is central to the planning and design of a cross-border investment—particularly since governments will generally choose to move expeditiously to lock in a national compact, rather than risk the more complicated, if higher-return, potential of a regional deal.

Outside funders do not have adequate incentives to work with countries to develop cross-border, regional projects despite their high returns. The multilateral development banks' (MDBs) still-limited experience explains why. With more than one partner country involved, negotiations are complex and upfront transaction costs mount quickly. The projects have long planning and implementation periods, and require strong and continuous implementation support.[3] Even so, successes are possible, as demonstrated by the Ethiopia-Kenya Interconnection energy project, supported by the African Development Bank and the SIEPAC power grid in Central America, supported by the Inter-American Development Bank.[4]

[3] World Bank. (2013). *Issues Remaining from the IDA16 Mid-Term Review*. IDA Resource Mobilization Department Concessional Finance and Global Partnerships. Washington, DC: World Bank.
[4] The Kenya-Ethiopia energy project supports a 1,068 km transmission line from Ethiopia to Kenya and focuses on cost effective and clean energy sources.

MCC has at least two advantages over other funders of large, cross-border investments in low-income countries. First, its grant financing eliminates the need to agree on the allocation of a repayment burden among beneficiary countries. Second, MCC's work on energy projects under the Power Africa umbrella indicates that the backing of the US Government is a powerful force in generating confidence on the part of both private investors and partner governments in "getting to yes" on a complex investment deal.

It's easy to think about how regional engagement might be beneficial in the context of electricity. The logic of a shared grid across borders is clear. To work, countries involved need to commit to a strong regulatory and financial structure outside the auspices of a single government for power trading and pricing.[5] Grant money can play an important role in supporting up-front technical work and provide comfort to private investors in the guarantee of purchasing power agreements.

As many of you have recognized with your support of the Electrify Africa bill, reliable, affordable energy access is a massive constraint to growth in Sub-Saharan Africa and elsewhere. A future regional power project covering Liberia, Côte d'Ivoire, and Ghana might be one promising pilot, for instance. MCC already has considerable experience with power under Power Africa and regional power investments in West and Southern Africa show potential.[6]

(2) A More Sensible Measure of Need for Country Candidacy

Congress should allow MCC to explore whether an alternative measure of need to Gross National Income per capita (GNI) could produce a candidate pool that better reflects the significant poverty and development need in potential partner countries; one option is median daily consumption per person.[7]

As set out in the agency's authorizing legislation, only countries with a GNI below $4,125 (for FY2016) comprise the starting candidate pool for MCC engagement. Millions of people who are poor by any reasonable standard live in countries above this cutoff; and many countries above that level, despite good governance today, are not yet on a secure trajectory of sustained growth. American taxpayers want to support building middle class, democratic societies in the developing world, in which good government emerges and persists as income-secure taxpayers have the wherewithal to hold their governments accountable.[8] Many countries with GNI per capita above $4,125 are not yet middle class societies.[9] Consider Tunisia, a struggling democracy where per capita GNI is above MCC's cutoff. Yet one half of its population survives on less than $8 a day (Tunisia's median consumption level), compared to median (income) in the United

[5] World Bank. (2008). Building Regional Power Pools: A Toolkit. Washington, DC: World Bank.
[6] The Southern Africa and West African Power Pools are examples.
[7] Data on median consumption or income is now available for more than 100 countries as a result of more frequent household surveys in the developing world. http://iresearch.worldbank.org/PovcalNet/index.htm?0,3
[8] Nancy Birdsall, Does the Rise of the Middle Class Lock in Good Government in the Developing World?". European Journal of Development Research **27**, 217-229 (April 2015).
[9] Nancy Birdsall, Nora Lustig and Christian Meyer, The Strugglers: The New Poor in Latin America?, World Development, Volume 60, August 2014, Pages 132-146, ISSN 0305-750X, http://dx.doi.org/10.1016/j.worlddev.2014.03.019.

States more than 10 times higher at over $50 per person a day.[10] The democratic government of Tunisia needs support if it is to stay on a trajectory of sustained, broad-based growth in a difficult region. Or Mongolia, also with median consumption of about $8, whose GNI per capita exceeds MCC's cutoff principally because of high foreign investment in its mining sectors, especially coal, copper, and gold. In Mongolia, it will take years to create the institutions and make the investments in health, education, roads, and energy that will bring the benefits of its newfound wealth to all of its people.

No single measure is perfect. Median consumption or income can be low because of a high concentration of income at the top of the distribution. But a country with low median income where corruption or tax or other policies fail to address high inequality would not be eligible for an MCC compact given the standards embedded in the MCC scorecard. Were MCC to adopt a measure like median income as a determinant of candidacy, the agency should consider investment grade and restrict partnerships with certain investment grade countries. Where the use of its grant resources is appropriate, MCC could target its funds to crowding in private investment.

(3) Focus on Funding Measurable, Verified Development Outcomes

Congress should support MCC in its ongoing efforts to pilot pay-for-performance approaches, such as Cash on Delivery Aid. These are agreements, developed by my colleagues and me at the Center for Global Development, in which donor agencies pay a partner country for the delivery of independently measurable and verified pre-agreed outcomes, like the number of additional households with affordable electricity access or average gains in learning of 10-year olds, rather than inputs such as new power lines or schools built.

Another approach—one which MCC is also exploring—is Development Impact Bonds (DIBs), also developed in part by the Center for Global Development. DIBs are also an outcomes-based approach in which private investors are invited to finance investments up front and are repaid if and when measurable results are verified. Given limited US assistance dollars, this leveraging of private sector impact investors should be particularly welcome. Other donors have begun to experiment with pay-for-performance schemes—including the World Bank (Program-for-Results) and the UK's Department for International Development.

Pay-for-performance schemes fit well with many aspects of MCC's model. They promote greater country ownership and encourage innovation by providing partner governments with increased flexibility to find the best ways, within their own local context, to achieve agreed-upon targets. The approach is particularly useful where countries need to implement politically or bureaucratically difficult reforms if expected results or outcomes are to be gained. Political and institutional reforms are difficult to measure. It is most effective for countries to undertake them because doing so is key to increasing, for example, energy access or raising agricultural productivity or reducing waiting time for ships and trucks at ports and borders.

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[10] This is a rough estimate; median household income in the US is about $50,000. At 2.5 people per household, per person median is about $20,000, or over $50 a day, http://www.census.gov/quickfacts/table/PST045214/00. Median consumption will be somewhat lower.

MCC has positioned itself on the cutting edge of thinking about results; to remain there it should push forward in its exploration of some of these new ways to link payments to outcomes.

(4) More Impactful Partnerships Through Subsequent Compacts

Congress should continue to allow MCC to enter into subsequent compacts. Development simply does not happen in five years, even with the most successful country partnership.

MCC was set up to work with well-governed developing countries. But development is a long-term project. It took Korea, one of the world's fastest growing countries in the 1960s and 1970s, something like 30 years to become what it is today: a middle class democracy. Tanzania (which is currently eligible for a second compact) would have needed to increase its per capita income by *over 900%—over 50% per year*—during the course of its first compact to reach upper-middle income status. More to the point, subsequent compacts can also capitalize on institutionalized relationships and lessons learned.

MCC's strict, five-year compact timeline is a feature that sets it apart from other US government agencies. But the importance of the timeline is in its application to each compact—providing an incentive for timely implementation and forcing reassessment of continued engagement—not to MCC's overall relationship with a country. Second compacts (and potentially beyond) should not be automatic; but where warranted, a longer relationship should be welcomed.

(5) Taking MCC Beyond MCC

Congress should help other US development agencies rise to the standard that MCC has set.

USAID and the State Department, which together control three quarters of US foreign assistance dollars, should—for far more of their portfolio[11]—clearly demonstrate value for money, apply greater country selectivity, give partner countries more responsibility for identifying and managing aid investments, and further their commitment to transparency and rigorous evaluation.

This is easier said than done. MCC benefitted from a fresh start as a new agency 12 years ago, and many of the features that have contributed to its excellence had been learned over many years in the aid community, and were hard-wired into MCC's culture and mandate from its inception. Compared to USAID, which is burdened with an accumulation over many decades of congressional directives on spending by country and sector as well as others, MCC has the flexibility to make reasonable demands on partner countries, to work with them on their own

[11] MCC's set of standard practices is not systematically appropriate for all US foreign assistance objectives and programs. USAID has important responsibility for emergency relief and humanitarian aid in many countries that would not be eligible for MCC support. In countries that are eligible, some efforts, like expanding the use of constraints analysis, a commitment made in the 2015 Quadrennial Diplomacy and Development Review, are more relevant for growth-focused programming. However, other aspects, such as cost-benefit-effectiveness analysis, country participation, evaluation, and transparency, can be applied more broadly, and across sectors and initiatives.

priorities, and to target results-focused investments (though still with appropriate oversight and quality controls).[12]

Congress must be a willing partner for a meaningful shift to take place throughout the US development apparatus. A review of the external constraints that prevent USAID from exercising greater flexibility would be a good start toward building on the lessons of MCC. I also recommend that Congress request a comprehensive review of directives and informal mandates that constrain USAID and undermine key principles of aid effectiveness.[13]

Conclusion

In conclusion, I hope that Congress will continue its strong bipartisan support for MCC and encourage the agency to continue to adhere to its model. But I also urge Congress to push MCC to explore innovations within its model that would allow the agency to have even greater impact.

[12] Andrew Natsios, for example, also complains of the effects of the counter-bureaucracy of inspector generals that have increased risk aversion at USAID. See "The Clash of the Counter-bureaucracy and Development," Washington, DC: Center for Global Development, 2010.

[13] For one example of how such a review might be structured, see, Casey Dunning and Ben Leo. "Making USAID Fit for Purpose: A Proposal for a Top-to-Bottom Program Review." *White House and the World.* Washington, DC: Center for Global Development, 2015.

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