

TESTIMONY
OF
Paul V. Applegarth
Chief Executive Officer
Millennium Challenge Corporation (MCC)
before the
Senate Foreign Relations Committee
April 26, 2005

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

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

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

The amounts in the original concept papers and Compact proposals totaled roughly \$4.5 billion. Through due diligence, elimination of items that did not contribute sufficiently to poverty reduction and growth, components that did not appear to arise from an adequate consultative process, and phasing of items that might unduly delay an initial compact, that total has been reduced to around \$3 billion. However, that amount does not include Morocco's proposal, which, given the size of the country, is expected to be fairly large. In short, proposals from eligible countries already are expected to exceed resources currently available by about \$1 billion. In addition, MCC estimates that the addition of new FY 2006

candidate countries, along with amendments to existing compacts, will increase the total requests from MCA-eligible countries by as much as \$3 to \$5 billion in FY 2006.

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

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

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

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

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

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

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

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

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

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

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

of these activities. Not surprisingly, these countries initially looked to MCC to do the same. Other countries produced “laundry lists” of projects which had been left on the shelf from earlier donor programs.

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

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

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

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

The concepts behind the MCC are bold and, as a package, unique. More importantly, they make sense for U.S. development assistance and for

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

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

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

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

In fact, the success of the MCC has already begun, as our role in the foreign assistance arena has yielded results even before spending money. Early indications tell us that our process is working. Morocco and Vanuatu have consulted NGOs and the business sector for the first time. The MCA incentive has also prompted reform; anecdotal evidence points to a strong MCA role. One country, for example, passed four pieces of anti-corruption legislation and began enforcement, in the hope of receiving MCC assistance. Since the announcement of MCA indicators in February 2003, the median number of “days to start a business” dropped from 61 to 46 in MCA candidate countries. Many countries have targeted corruption -- a primary

MCC indicator-- and are making strides to reduce corruption within their governments. Bangladesh's finance minister, Saifur Rahman, while proposing a tough program targeting corruption, cited his country's exclusion from MCA eligibility specifically as an example of the heavy price his country was paying for being branded a corrupt country. One official from an eligible country said, "even if we receive less than requested, the intangibles gained from taking control of our own development destiny are the most important part of the process."

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

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

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

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

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

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

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

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

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

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

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

The Millennium Challenge compact development process (Appendix 1) is thorough and it has never been done. As a point of reference, in the private sector, when an investment proposal is received, the parties have

been through the process before, the objectives are known (e.g., financial return or credit-worthiness) and the management organization and implementation plan are known.

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

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

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

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

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

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

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

A Washington seminar for all Ambassadors to the U.S. from eligible countries

Outreach with a similar message to U.S. Ambassadors and USAID mission chiefs during country visits.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As we move forward with our other compact negotiations, we are seeking input on a Natural Resources Management indicator from a broad range of natural resource experts from academia, think tanks, and NGOs.

Furthermore, we have an ongoing and active dialogue with these groups and institutions about MCC operations and policy matters of mutual interest. We are grateful to them for their support and their constructive feedback on issues such as the consultative process. In fact, with regard to that issue, these groups have even mobilized their partner groups in countries to engage in the consultative process and to provide us feedback, which we greatly appreciate.

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

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

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

Appropriations below \$3 billion for FY06 will most likely require reductions in the number or scope of MCC Compacts, and/or force the MCC to forego funding good proposals. Such reductions would undercut MCC's effectiveness in having a significant impact on poverty reduction and economic growth.

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

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

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

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

I welcome any questions you might have.