Incentives and Capacity at the Millennium Challenge Account

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The MCA: A New Development Paradigm

In March 2002, the Bush administration announced a new approach to development called the Millennium Challenge Account (MCA). Lauded in the press as "an audacious attempt by the Bush administration to rewrite the rules of foreign development assistance," the MCA was designed to be free from the constraints of contradictory, and sometimes self-defeating, Congressional earmarks that have historically reduced or crippled other organizations' ability to react efficiently. In addition, the Millennium Challenge Corporation (MCC), which manages the MCA, would also be above the morass of legislation that makes many government bureaucracies cumbersome and inefficient. The MCA was designed to be less constrained by American foreign policy considerations, which would increase the amount of time and resources that the MCC could dedicate to promoting transformative change. Since their inception in January 2004, the MCA and the MCC have fulfilled their promise through an emphasis on performance and competition, while working exclusively with countries that have met certain preconditions that would allow them to use aid more effectively. The eligibility criteria imposed on MCA recipients, limit aid to only those countries that have demonstrated a commitment to ruling justly, promoting economic freedom, and investing in people; measured by sixteen, third-party, non-US-government indicators in a process that is open to the public. The three policy categories were selected on the basis of their clear empirical correlation with economic growth and thus the reduction of poverty. From day one, the MCC clearly explained the principles that would guide the selection and approval of programs: host country ownership, the overcoming of key impediments to economic growth and poverty reduction, and the integration of monitoring and evaluation.

MCA in Theory

In theory, once a country becomes eligible for MCA funding (i.e. once the sixteen policy indicators tracking commitment to growth-oriented policies show that the country has taken clear steps to establish the rule of law and participatory governance, to invest in health and education, and to provide the context for private sector-led development) the MCC's board may select that country for inclusion in the program; the Board makes its selections annually. If selected, that country is free to develop and present a proposal for an economic development program that would mitigate one or more clearly identified economic impediments.

At their own expense, and typically with their own resources, the countries then develop their proposal; in addition to the private sector, the MCA-eligible country is required to consult broadly among civil society, special interest, minority, and women's groups during this process. Strong, coherent proposals identify economic impediments through a broad-based consultative process, state a good case for requesting funding for the activities described within, and clearly state the expected impact that the designed program will have on both the nation's economy and its people, particularly the poor.

The MCC receives proposals from eligible countries, and with due diligence determines the merit and viability of the proposed programs. Proposals are evaluated on technical feasibility, the appropriateness and reasonability of the amount of funding requested, the likelihood that the program will have a transformative impact, and whether or not there was sufficiently broad consultation of the country's citizens. Proposals are also expected to comply with statutory restrictions that prohibit, for example, child labor or severe environmental damage. Finally, the MCC acts on behalf of the United States tax payers, ensuring that money goes to investment worthy projects that will lead to measurable results.

MCA in Practice

Although the MCC set out to manage international development programs differently, in practice both the MCC and the first round of MCA-eligible-countries faced a substantial learning curve in transforming the MCA concept from idea to reality. In May 2004, three months after MCC's inception, the Board designated 16 eligible countries for MCA funding, and the clock began to tick for a small staff of roughly 30 people. Faced with such limited resources, the MCC gave all countries an equal opportunity to submit proposals, but gave first priority to countries that were ready with good proposals, the first of which was submitted in August 2004. As early as December 2004, it was clear that the MCC was not disbursing aid as quickly as some eligible countries had expected, especially the countries that thought the mere act of submitting a proposal entitled them to funding. Pundits began to criticize the MCC for moving too slowly and for disbursing too little aid.

Though the overall ideology governing the MCC is well supported and propitious, details that were left undefined have caused difficulties from the beginning. For starters, the program's inception quickly strained the resources of the small initial staff at the MCC. Working with the fastest countries first, the MCC was able to move quickly with a few countries, but the limitations of its human resources left other countries with little help or attention. MCC has ameliorated this constraint over time with additional staff and external resources, but this response did not happen quickly enough to quell the initial criticisms of the institution.

Second, the MCC was accused of requiring overly rigorous, time consuming, and expensive analytical studies that denied legitimately qualified countries the hope of ever presenting an acceptable proposal. However, it is important to remember that the proposal process was intended to be a challenge from the start. MCC expects that the challenge of designing, developing, and implementing these programs will foster a sense of ownership in the applicant countries. This process also aims to ensure popular support for continued involvement in the program; too many projects completed with international funding have crumbled afterwards due to the country's failure to maintain them. Popular opinion holds that since the donor paid for the project, it is for all practical purposes the donor's project, and the donor should pay again if the project needs repair or additional funds.

Third, the development community has long been accused of treating the developing world with condescension, designing programs on its behalf and imposing its own desires or requirements. But the MCC, by addressing this criticism in its program design, faced a separate concern: that MCA-eligible countries, unable or unaccustomed to this new responsibility, would struggle with the task, propose insufficiently developed or poorly-designed programs, or lack the capacity to even develop a good proposal. In more than one country, the consultative process revealed a popular desire for services that the host government was ill equipped to provide due to lack of adequately prepared engineers, economists, or agricultural specialists.

The issue is a catch-22; some poor countries lack these professionals because there is no work for them to do, and any locally trained professionals emigrate elsewhere to find work in their field of study and remain expatriates. Often there is too little work for locally trained professionals, because multilateral development banks and donor agencies bring the full weight of their technical expertise to developing countries, which effectively eliminates the local demand for trained personnel. In other cases, war has seriously reduced the stock of trained professionals available to work for a government developing its MCC proposal. Even for some countries with greater levels of technical capacity, the process of project identification, popular consultation, and compact negotiation was a novel one that required much learning. However, the MCC is pleased to see that the second round of MCA-eligible countries has learned from the challenges faced by the first round countries, and, as a result, expects even stronger proposals forthcoming.

The program development capacity of an MCA-eligible country is one of the most critical elements of the application process, particularly because strong country teams and well-developed proposals are key determinants of the duration required for the due diligence process. The MCC's experience has shown that where applicants have quickly appointed a capable and well-qualified proposal team, better quality proposals and a shorter due diligence process have been the result. Whereas governments that were slower to appoint teams, appointed less-qualified staff, or were unwilling and/or unable to provide adequate resources for program development have required a longer amount of time to complete the due diligence phase of proposal analysis.

Given the importance that the MCA gives to the principle of host country ownership, it is crucial that the MCC does not have – and should not have – control over the composition of the proposal team or the quality of the proposals; the proposal is the first critical, although difficult, step in a process that could last a decade or more. With greater incentives to produce, retain, and employ local professionals, the local job market for such professionals will grow, and the skill set available to growing nations will expand. The MCC anticipates that application process will help to develop a growing local base of well-educated professionals and have a substantial, positive impact on the level of human capital in applicant countries. There is ample evidence to support the idea that there is a growing familiarity with the MCA model, which has been a significant departure from the traditional roles of donors. Not every country initially understood the MCC's definition of country ownership, and, as a result, many early proposals did not reflect a thoroughly consultative process; some proposals, instead of addressing one or two key economic impediments, presented an incoherent laundry list of small pet projects. The MCC soon realized how challenging the proposal experience had been for eligible countries to design a program for a donor agency that had no intentions of "filling in the blanks." Maintaining its commitment to the MCA application as a learning process, the MCC began to provide more specific guidance to applicants, and, with added staff resources, was able to work more closely with each country to guide it through the process.

Impact of the MCA

Using the metric of aid dollars spent, the MCC was roundly criticized as ineffective during its first two years of operation, but such criticism overlooks the reason MCC was designed to be different from other aid agencies: it has long been clear that more money alone does not lead to more – or faster – development. That is why it is important to take a wider look at what the MCA has achieved in its two short years on earth.

First, MCC has prompted positive change through its willingness to say “No.” In refusing to proceed with Nicaragua’s compact—including over $100 million in funds for a massive roads rehabilitation program—until a funding mechanism was established to provide for ongoing road maintenance, the MCC helped Nicaragua to institutionalize a road maintenance program for the first time in its history. The effect of this has been that not just MCC roads, but all roads will receive adequate maintenance in the future. In Lesotho, the MCC proposal development process has resulted in an ongoing effort to reform issues of land title and equality under the law. As a country that had, up until that point, denied women the right to own land, the effect of this major policy change will be felt for generations. And the very restrictive nature of MCA eligibility has promoted policy change in more than one country denied access to MCA funding, including El Salvador, which studied the factors that had caused it to be denied in the first round and addressed them in time to win eligibility in the second round. On one occasion, the leader of an African country met then-CEO Paul Applegarth at a diplomatic function and proudly produced the latest report from Transparency International to show that his country had improved on the corruption index.

Success stories like these show that the MCA has indeed left its mark on the world even before substantial dollar amounts have been disbursed. The incentive effect—created by selecting only countries that have adopted and are adhering to good policies—has shown more results so far than the projects themselves. That is exactly what MCC was designed to do in the short and medium term. The longer-term success of MCC will by seen in the results of MCC-funded projects, an improvement in host country capacity, and growing familiarity with a new development paradigm. By requiring that host countries shoulder the burden of designing and implementing a results-oriented development program, MCC creates an important incentive for developing countries to train and retain the sort of thinkers and leaders that will shape these nations’ futures. Keeping this incentive structure in place—even if it means that compacts continue to be developed at a pace commensurate with each country’s relative strengths and weaknesses—will eventually build the country’s capacity to take charge of its own development so that it no longer needs aid institutions like the MCC. And that is the goal of development assistance in the first place.