Millennium Challenge Corporation

Overview of the Compact Development Process

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MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

General Principles of Compact Development

MCC asks that countries develop Compacts with a number of key principles in mind[1]:

- ★ **Poverty Reduction through Economic Growth:** MCC's goal is to assist partner countries to reduce poverty by making investments that stimulate sustainable economic growth. While MCC does not have any preference for specific sectors to invest in, we do ask that these investments address key constraints to economic growth and result in poverty reduction.

  MCC believes a country's development is sustainable only if aid is eventually replaced with economic activity and investment led by the private sector, and if investments enhance environmental and social sustainability. MCC's role is meant to be transformational and transitional as assistance is replaced by private capital flows.

- ★ **Reward Good Policy:** MCC eligibility is limited to countries that govern justly, invest in their citizens, and promote economic freedom. Backed by lessons learned from development practice, MCC believes good policies promote an environment for sustainable economic growth and poverty reduction, and thus for MCC investment. Eligible countries must maintain their good policy performance on the selection criteria to remain eligible for MCC assistance. Policy improvements may also be needed to achieve the objectives of an MCC investment.

- ★ **Partnership and Country Ownership:** Eligible countries are asked to demonstrate leadership and a high level of commitment through full ownership of the compact development process. Working closely with MCC, eligible countries will be responsible for identifying the greatest constraints to their development, ensuring civil society participation, and developing a Compact. Intensive upstream and ongoing engagement by MCC is crucial to increase the likelihood that compact projects are suitable for MCC financing.

- ★ **Focus on Results:** MCC assistance will be provided to those countries that have developed well-designed Compacts with clear objectives, benchmarks to measure progress, procedures to ensure fiscal accountability for the use of MCC assistance, and a plan for effective monitoring and objective evaluation of compact program results. Compacts should be designed to be sustainable even after MCC funding has ended.

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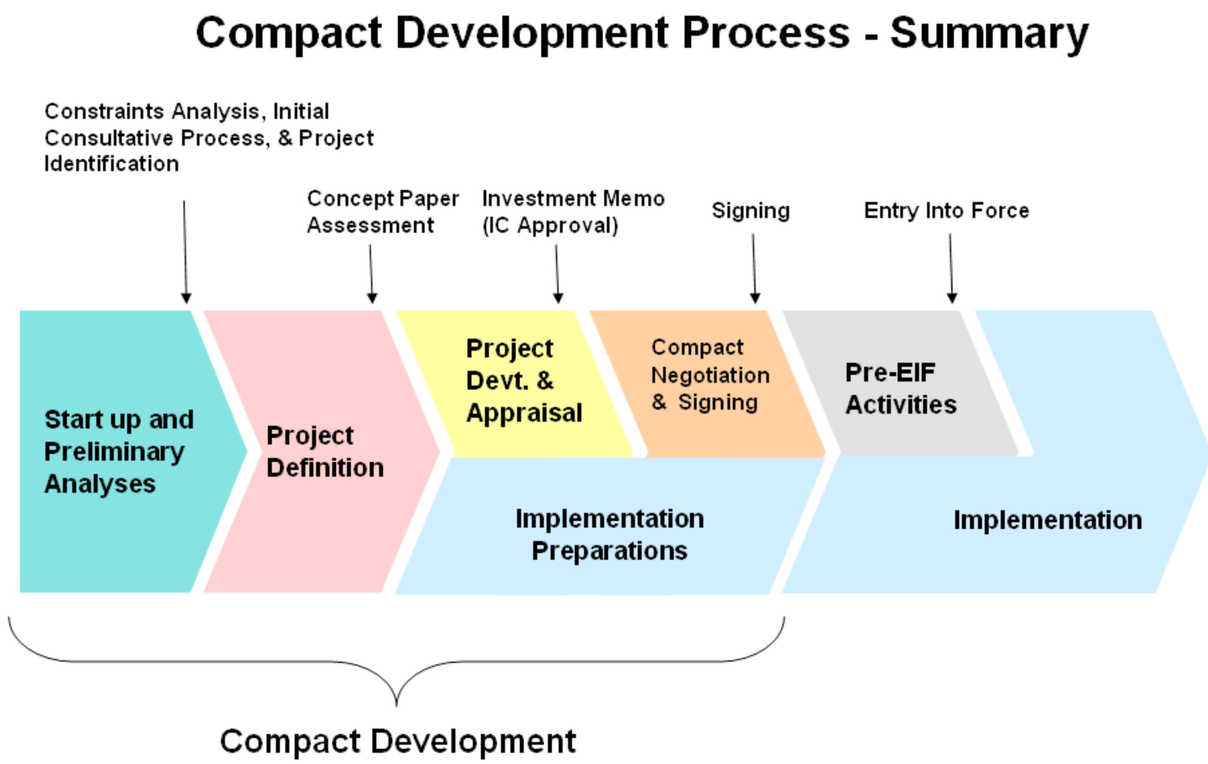
1 Throughout this document, the following terminology is used: (i) Compact or compact program – refers to the overall package of investments under consideration by MCC; (ii) Concept Paper – refers to a proposal submitted by an MCA core team for a specific project within the overall compact program; (iii) project – refers to the subject project of a Concept Paper.

Phases of Compact Development and Principal Tasks

Figure 1 provides a summary of the phases of compact development, and Figure 2 at the end of this section provides a more detailed snapshot. Each phase is described in more detail below.

Figure 1



I. *Phase 1 – Start-up and Preliminary Analyses*

After selection by MCC's Board, eligible countries are asked to (i) recruit a National Program Coordinator, (ii) recruit a country core team, (iii) conduct a constraints analysis, and (iv) commence public consultations, as described below:

- ★ **National Program Coordinator:** Identify a full-time National Program Coordinator (NPC) to lead the country's compact development process and to manage its day-to-day relationship with MCC.

- ★ **Country Core Team:** Take the necessary steps to recruit and adequately fund an MCA country core team (core team) led by the NPC that is empowered to run the compact development process, enjoys a high level of political commitment, and has access to senior officials so that it can quickly make decisions. Countries that have assigned personnel full-time and have dedicated financial and administrative resources have developed their proposals and moved to Compact faster than those that did not. Core teams will need a variety of expertise over the course of compact development, including for economic analysis, monitoring and evaluation, environmental and social issues, sector specialists, project development and management, financial management, procurement planning and legal counsel. Chapter 6 provides detailed guidance on the characteristics and membership of effective country core teams.
- ★ **Constraints Analysis:** Conduct an analysis of the principal constraints to economic growth and poverty reduction, and, if appropriate, more detailed sector analyses. Chapter 7 provides summary guidance on the constraints analysis requirement.
- ★ **Consultative Process:** Initiate a timely, participatory, and meaningful consultative process with the country's civil society, non-governmental organizations and private sector to discuss further key constraints to economic growth and poverty reduction, and to identify priority activities to help address these constraints. Chapter 8 summarizes the key elements of the consultative process through all phases of compact development.

II. Phase 2 – Project Definition

A. Project Concept Paper Development

Based on the constraints analysis and initial public consultations, the country core team then analyzes more thoroughly specific problems and opportunities to identify possible projects for MCC funding. In narrowing its focus on potential projects, the country also considers current and expected assistance provided by other donors and attempts to identify funding gaps. MCC has adopted the Results Focused Project Design and Logical Framework methodology used by the Asian Development Bank and other donors, and country core teams are encouraged to use this or similar results-focused approaches to define projects.[2] The objective of this methodology is to avoid country core teams submitting as project proposals a set of solutions, without a clear analysis of the problem they are trying to solve, and the alternatives considered. The methodology also relies on focused stakeholder consultations, as part of the ongoing consultative process.

2 Please see *http://www.adb.org/Documents/guidelines/guidelines-preparing-dmf/default.asp*

MCC is ready and willing to provide assistance during the project definition phase. MCC also can provide countries with a toolkit and advice on how to integrate the private sector into compact activities, including the wide spectrum of possible public-private partnerships (PPPs).

Once the country selects its initial pool of potential projects for MCC investment, it prepares and submits a Project Concept Paper for each, describing the (i) project rationale, activities, and costs, (ii) sector context and regulatory environment, (iii) existing preparatory work, (iv) expected benefits and beneficiaries, (v) environmental and social risks, (vi) mechanisms in place or contemplated to ensure sustainability, and (vii) proposed implementation arrangements. The Project Concept Paper template is provided in Chapter 9.

The Project Concept Paper is designed to minimize investment risk by:

- ★ Providing countries an opportunity to clarify, organize, and prioritize their own investment ideas in written form, as well as to establish the programmatic logic that underlies them, before investing substantial time and resources into full project development;
- ★ Providing an early platform for detailed discussions on the rationale, feasibility, and risks of projects still at the conceptual stage, and agreement on which projects merit resources for further development;
- ★ Giving MCC an opportunity to provide upstream guidance to countries on the structure, approach, activities, and other aspects of project concepts before they are fully developed; and
- ★ Helping MCC and partner countries reach agreement on outstanding issues that need to be addressed to develop fully the project concepts into detailed investment proposals; the related assessments, studies, and data that will be required; and the funding and timing of this work.

B. Concept Paper Assessment and Peer Review

Upon receipt of Project Concept Papers, MCC undertakes the following steps, explained in more detail below: (i) initial assessment and draft Concept Assessment Memorandum, (ii) formal internal peer review, (iii) informal external peer review, and (iv) preparation of the final Concept Assessment Memorandum (CAM), which is cleared by MCC management, and transmitted to government.

1. Initial Concept Paper Assessment: This step is conducted primarily by MCC, and concludes with a recommendation to proceed to full project development, postpone a decision pending receipt of further information from the country or further investigation by MCC staff, or reject the project concept outright. The assessment focuses on a range of project risks, including:

- ★ **Rationale:** Is the project rationale sound? The project addresses a key constraint to growth and poverty reduction through a set of clearly defined project outcomes supported by project outputs generated through investments in specific activities. The project would not displace or crowd out private investment. It complements rather than duplicates the activities of other major donors.

- **Expected Impact:** Do the benefits sufficiently outweigh the costs? The preliminary economic analysis provides a rate of return above the country hurdle rate, based on internationally accepted models for benefit-cost analysis. Moreover, it is desirable that substantial benefits flow to the poor.
- **Sustainability:** Is the project sustainable? The project concept describes the policies and practices that will ensure financial sustainability of investments, supported by the legal and regulatory framework, to enable MCC investments to continue to provide benefits in the future.
- **Environmental and Social Issues:** Does the investment pose serious risk to the natural and human environment that must be mitigated, or require significant land acquisition, resettlement and other forms of compensation?[3] Does the project enhance environmental or social benefits, or enhance the sustainable use of natural resources?
- **Implementation Risk:** Can the project be implemented in five years? The agencies proposed for implementation roles have the demonstrated capacity to manage the project, and the scope and complexity of work can be completed within five years using MCC implementation procedures, and based on relevant local and international experience.
- **Level of Preparation:** What additional studies are needed to develop the project concept into an investment proposal suitable for consideration by MCC management and Board of Directors?

2. Two-Stage Economic Analysis: As part of the assessment, MCC economists will review the economic analysis provided by the country core team, and prepare if necessary an initial ERR model for each project. The purpose of this initial model is to capture the main drivers of the costs and benefits to determine a preliminary estimate of each projects' viability. A more sophisticated model will be developed for those concepts that MCC and the country agree to pursue.

3. Recommendation: Following internal and external peer reviews of MCC's initial concept assessment, MCC prepares a final communication to the government and country core team. This communication generally will take the form of a short letter outlining MCC's decisions and next steps, addressed to the National Program Coordinator or senior government official charged with overseeing compact development. It is important to note that a decision by MCC to support further project development does not constitute a commitment to finance proposed projects.

3 Please see http://www.mcc.gov/countrytools/compact/fy07guidance/english/20-enviroandsocialassessment.pdf

III. Phase 3 – Project Development and Appraisal

A. Project Development: Generally, MCC staff will travel to the country to review the CAM with the country core team and senior government officials, agree on next steps and additional studies, and conduct field work, consultations and research to resolve outstanding issues identified during the concept assessment.

The project development phase will entail completion of requisite project preparatory studies, including inter alia feasibility and preliminary design studies, environmental and social assessments[4], and economic and beneficiary analyses. Whether project development studies are funded by the country or through 609(g) grants (see Section B, below), the transaction team and country core team should agree on the objectives, terms of reference and timeline for each major work product. Another crucial aspect of project development is the design of project implementation structures and arrangements.

Typically it will not be possible to complete all of the planned studies for all projects prior to submission of the overall program for Board approval and compact signing. The objective is to minimize investment risk by attaining as much certainty as possible about the scope, activities, costs, mitigation measures and implementation arrangements prior to commitment of funds, and to minimize the time needed to enter into force.

B. 609(g) Funding: When countries require financial assistance to undertake these additional studies, MCC can provide limited financial support using "609(g) funds."[5] MCC either will administer these funds on behalf of the recipient country, or conclude a 609(g) Agreement with a recipient country that will then procure technical expertise using MCC's Program Procurement Guidelines.[6]

When MCC manages 609(g) compact development resources on behalf of a recipient country, both parties generally will set out their respective roles and responsibilities in a memorandum of understanding (MOU). The objective of the MOU is to ensure that:

- ★ Country counterparts fully own the further development of their projects by assigning their own experts to work with all key contractors;
- ★ Arrangements for joint management and supervision of studies have been agreed with the country to promote country ownership of results, while retaining MCC's rights as contract manager.

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4 These assessments will support the design of safeguards to ensure projects are implemented in an environmentally and socially responsible manner, consistent with MCC's Environmental Guidelines (*http://www.mcc.gov/countrytools/compact/fy07guidance/english/20-enviroandsocialassessment.pdf*) and Gender Policy (http://www.mcc.gov/countrytools/compact/fy07guidance/english/14-genderpolicy.pdf).

5 The term "609(g)" refers to a section of the Millennium Challenge Act of 2003 that authorizes MCC to finance compact development and implementation activities. According to MCC's Policy Regarding 609(g) Compact Support Funding, 609(g) funding "is intended to assist eligible countries only after they have made significant, tangible, and material contributions of their own resources to develop a Compact proposal."

6 Please see http://www.mcc.gov/documents/mcc-guidelines-programprocurement.pdf

- 609(g) financed consultants receive the support they need from the country core team and all relevant government agencies to maximize their productivity and the quality of their work. Support includes counterpart experts, logistics (meeting arrangements, when needed), office space, data, and access to project sites and stakeholders.
- MCC and the country core team consider and assess the contractors' work product together

609(g) funds also may be used to finance the initial setup costs for the MCA Accountable Entity, including office rental and salaries for key staff, as well as the costs of procurement and fiscal agents (PA and FA). These and other implementation preparation activities are described in more detail in Section V below.

C. Appraisal: Based on the draft or final reports of project development studies, the transaction team assesses the viability of the proposed projects, with assistance from the internal peer review panel. At this stage MCC and the country core team may need to agree, through technical negotiations, on adjustments in project scope, approach or design, to enhance impact, quality, implementability, and/or reduce costs. These technical negotiations are the heart of the appraisal process, and need not take more than a few weeks, given that the country core team will have been involved in the project development studies from the outset. Where detailed assessments identify fatal flaws that cannot be mitigated through such modifications, MCC may decide to remove the proposed project from further consideration.

IV. Phase 4 – Investment Committee, Compact Negotiation and Signing

During this phase, MCC and the country conduct negotiations on the legal documents that codify the technical content and administrative and implementation arrangements of the Compact. An Investment Memorandum is submitted to MCC's Investment Committee for approval and, if approved, the text of the compact legal document will be negotiated. Thereafter, the Compact is submitted to the MCC Board of Directors for approval and MCC and the country sign the approved Compact.

V. Phase 5 – Implementation Preparations / Pre-EIF Activities

As illustrated in Figures 1 and 2, and discussed briefly in Section III, implementation preparations should begin well before compact signing. As the Government recruits key MCA Accountable Entity staff and the Procurement and Fiscal Agents, identifies office space, and agrees on Implementing Entities, MCC may finance implementation training through the 609(g) funded capacity building initiative, using general modules and curriculum currently under development to cover the following areas:

- Financial management;

- ★ Accounting;
- ★ Auditing;
- ★ Budgeting;
- ★ Procurement;
- ★ Project management;
- ★ Monitoring & Evaluation; and
- ★ Board Governance

The following activities, typically scheduled after compact signing, may in some cases commence sooner based on progress with compact development as of signing, and in standing up the country's compact management and governance structures.

- ★ Recruitment of second tier and support staff
- ★ Selection of office space and execution of lease agreement
- ★ Procurement of office equipment and vehicles
- ★ Procurement of IT network including IT architecture and equipment
- ★ Establishment of MCA website
- ★ Establishment of Common Payments System
- ★ Development of 5-year procurement plan
- ★ Development of project work plans
- ★ Completion of any remaining feasibility studies, commencement of design studies
- ★ Drafting of the monitoring and evaluation plan
- ★ Collection of monitoring and evaluation baseline data
- ★ Establishment of bid challenge system
- ★ Development of Fiscal Accountability Plan (FAP) and Procurement Operations Manual (POM)
- ★ Set-up of integrated financial and procurement management information system
- ★ Joint MCA-MCC implementation workshop
- ★ Board training

★ Development of initial tender documents for civil works and other large contracts

★ Preparation of legal documentation for entry into force

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Phases of Compact Development

1. Start up and Preliminary Analyses
2. Project Definition
3. Project Development and Appraisal
4. Compact Negotiation and Compact Signing
5. Pre-Entry into Force Activities
6. Implementation

Implementation Preparations

Getting started:

- Country names National Program Coordinator – key manager of the compact process
- Country establishes Core Team – responsible for completing the compact
- Country commences initial public consultations
- Country completes analysis of binding constraint to growth
- MCC provides feedback on analysis of binding constraints to growth
- MCC provides guidance on results focused project design principles and tools

Identifying priorities:

- Country consults stakeholders on potential projects
- Country develops and provides a Project Concept Paper for each potential project – each paper proposes a set of related investments
- MCC conducts a "peer review" of the proposed Project Concept Papers; MCC may undertake fact-finding mission to country
- MCC provides formal response to Project Concept Papers – identifying suitable candidates and indicates further studies that may be needed
- MCC provides 609(g) funding if needed for project development of approved concepts

Developing the program:

- Country further develops projects that appear promising for potential investment
- MCC disburses 609(g) funding and assists with needed preparatory studies –feasibility studies, environmental impact assessments, framework resettlement plans, preliminary designs, etc.
- Country consults stakeholders on project design and sustainability
- At an appropriate time, MCC prepares and submits Congressional Notification to commence negotiations*
- MCC conducts formal appraisal of developed projects, including second "peer review"

Negotiating the terms of the Compact:*

- MCC and country conduct compact negotiations (technical content)
- MCC prepares and submits Investment Memo to MCC Investment Committee
- MCC and country negotiate compact documents (legal documentation)
- MCC Board approves Compact
- MCC and country sign the Compact -- at this point funds are obligated, program objectives are defined and total dollar amount is set

Getting ready for implementation:

- Compact ratification, if necessary
- Completion of stand-up of Millennium Challenge Account (MCA) Accountable Entity
- Completion of Implementing Entity agreements
- Completion of annual budgets and implementation plans
- Completion of Terms of Reference and work plans for implementation and procurement
- Pre-qualification of consultants and contractors for early procurements

The clock starts:

- Compact "Enters Into Force" (EIF) and five year clock starts
- Compact provisions in full force and effect in the country
- Accountable Entity is responsible for overseeing implementation of projects
- PMU submits quarterly progress reports
- MCC authorizes disbursements, U.S. Treasury transmits funds
- Ongoing public updates on Compact
- Monitoring and evaluation of project impacts
- MCA Consultation may include: transparency; outreach; stakeholder committees; resettlement process, etc.

- **Country sets up its Project Management Unit (PMU) structures –** Accountable Entity, Fiscal Agent, Procurement Agent, and Implementing Entities established and trained

* As defined under Section 610 of the Millennium Challenge Act of 2003