

Millennium Challenge Corporation

Guidance on Second Compacts

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MILLENNIUM
CHALLENGE CORPORATION

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Second compacts are consistent with MCC's mandate to invest in poverty reduction through economic growth. For the poorest countries, even the ones with the right policies to support growth, it takes years of sustained growth to lift citizens out of poverty.¹ MCC seeks to work with partner countries – both new and existing – where investments will have the greatest returns in terms of poverty reduction and economic growth, and where U.S. resources will be used effectively. MCC therefore seeks to work with countries already committed to policies that support growth.

MCC is selective in choosing partners eligible for second compact agreements, and MCC does not intend to have open-ended commitments with partner countries. In fact, eligibility for a second compact is more difficult than for a first compact because, in addition to candidate countries' policy performance, MCC considers country performance in implementation of the first compact. Countries must show meaningful progress toward achieving first compact results before being considered for a second compact.

Building on experiences and knowledge gained during first compact implementation, MCC expects to see an evolution in the nature of its relationship with second compact countries. This includes significant country resources in compact development and implementation; increased emphasis on seeking compact partnerships with the private sector, other donors and civil society organizations; increased emphasis on ensuring that social and gender analysis is integrated into compact processes; explicit application of lessons learned in first compact implementation; and a continued high standard for sustainability of outcomes from MCC-funded investments. With these aims in mind, MCC's investment decisions for second compacts will continue to be based on the potential for proposed investments to support economic growth and poverty reduction.

MCC's formal engagement with partner countries for second compact development begins once a country is deemed eligible for a second compact by the MCC Board of Directors. Prior to this, MCC is available to clarify questions about this guidance, but will not dedicate technical staff time or resources to review or support compact proposals. Once countries are deemed eligible for second compacts, country counterparts are responsible for leading project proposal and compact development, according to the MCC guidance described below. MCC will enter into compact agreements only upon identification, development, and negotiation of project proposals that have promising returns to economic growth.

This document provides an overview of MCC's approach on second compacts, including selection of partner countries, and guidance for developing compact proposals.

¹ For example, even though it was the world's fastest growing economy for years, it took Botswana 30 years to go from an average annual per capita income of \$675 to \$4,300 in 2006. (Source: Center for Global Development, *U.S. Assistance for Global Development*, 6/15/2006.) At this per capita income level, Botswana has graduated out of the Lower-Middle Income Country category, and is therefore not a candidate for partnership with MCC.

1. Country Selection for Second Compacts

The selection of countries as eligible for MCC assistance is a decision by MCC's Board of Directors. The Board's determination of eligible countries is based primarily on country performance on MCC selection indicators. For a country to be selected as eligible for an MCC assistance program, it must demonstrate a commitment to just and democratic governance, investments in the people of a country, and economic freedom as measured by 17 different policy indicators. In determining country eligibility, the Board also considers the opportunity to reduce poverty and generate economic growth within a country, and the availability of MCC funds.

In addition, for countries that are candidates for second compact selection, the Board considers each country's performance implementing its first compact. To assess first compact implementation performance, the Board considers country performance in three general areas:

- ★ Progress towards achieving compact results, including significant progress relative to the planned compact timeline and on process and output indicators, degree to which compact programs are on track to reach compact targets, and level of commitment to monitoring and evaluation plans included in the compact.
- ★ The nature of the country partnership with MCC, including political will and capacity to implement compact programs, pro-active management of implementation challenges, and achievement of policy reforms associated with compact investments.
- ★ The degree to which the country has implemented the compact in accordance with MCC's core policies and standards, including in the areas of preventing fraud and corruption, procurement, environmental impact, gender integration, monitoring and evaluation, and legal provisions as defined in the compact agreement and other supplemental documents.

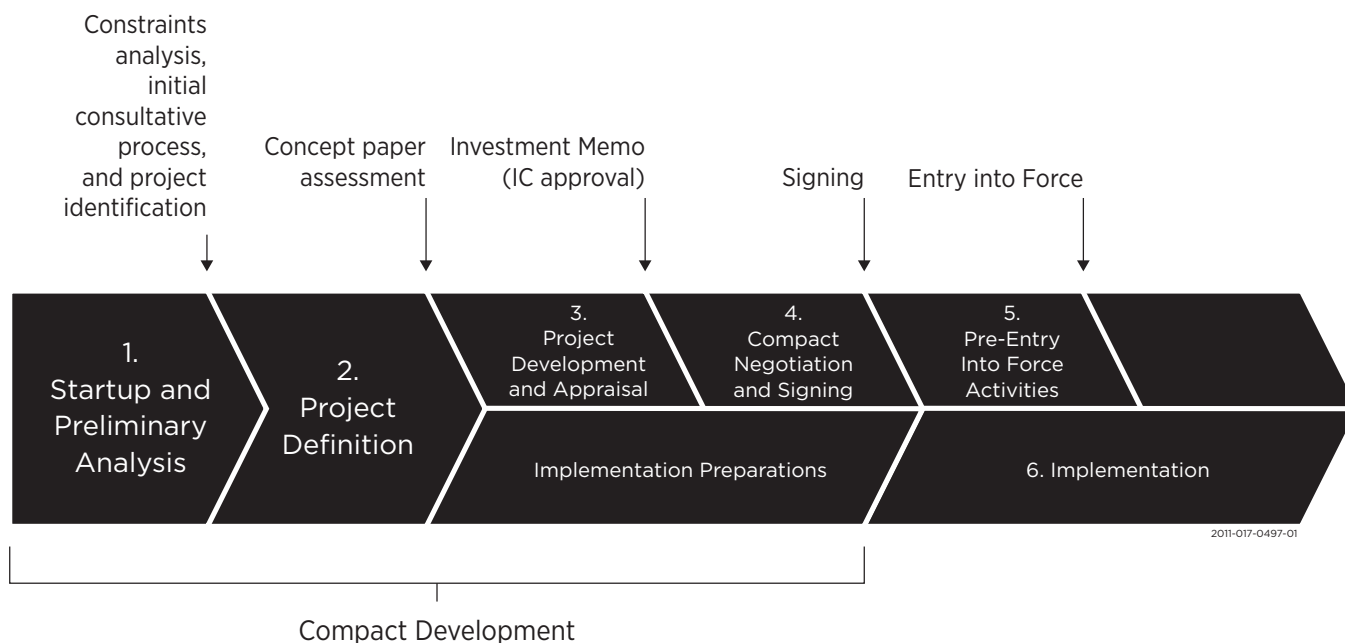
2. Guidance for Compact Development

Overview of the Compact Development Process

The starting point for second compact development is MCC's current guidance for development of all compacts, available at www.mcc.gov. All second compact proposals (both those that build on first compact programs and those that propose different sectors or approaches) will be assessed according to MCC's standards for economic growth and poverty reduction.

The process for developing compact programs has evolved significantly since 2006, building upon lessons learned from implementation of earlier compacts and founded on the belief that a closer early partnership, with more clearly defined milestones, increases the likelihood of more effective compact development and implementation. The figure below summarizes the phases of compact development.

Compact Development Process Summary



The major refinements to this process since 2006 are summarized below. Some or all of these steps will be new to early second compact countries. In general, MCC puts greater emphasis on more intensive upstream engagement with partner countries to set expectations and communicate investment standards.

- ★ Each country prepares a **constraints analysis** identifying key constraints to economic growth through a rigorous analytical framework, developing a shared understanding of country needs and providing a framework for targeted public consultations and subsequent investment ideas. Where the analysis identifies sector-specific policy, regulatory or management issues as key constraints, or as important for maximizing impact of proposed investments, MCC invites country proposals for funded projects that specifically address reforms in these areas.
- ★ **Public consultations** are now more focused on sectors and policies identified as key constraints to growth. MCC offers tools to facilitate these consultations and to identify potential investments, including Results Focused Project Design / Logical Framework methodologies, and guidance on private sector engagement.
- ★ Each country prepares **concept papers** as a first step for potential projects, rather than submitting detailed compact proposals. These concept papers serve as the basis for MCC and its country partners to prioritize potential projects and provide an early platform for detailed discussions on the rationale, feasibility, and risks of project at the conceptual stage. They also serve to focus MCC and country resources by identifying at an early stage those projects which are unlikely to be considered suitable for MCC investment because of project risks or tenuous links to economic growth and poverty reduction, before significant investment has been made in developing them.

- ★ MCC has a high standard for program preparation prior to compact signing, and requires completion of as many of the necessary **project preparatory studies** as possible prior to submission of the overall program for Board approval. These include feasibility and preliminary design studies, environmental and social impact assessments, economic and beneficiary analyses, and gender analysis. Such studies help increase the certainty of cost estimates, prepare mitigation strategies for environmental and social impact issues, ensure projects are designed for maximum impact, and reduce implementation and completion risks. MCC can provide limited financial support to undertake these additional studies.
- ★ For countries that propose the use of existing country systems for procurement and financial management of MCC-funded programs, MCC has developed guidance on **assessment for use of country systems** to make transparent the factors that it considers in assessing these proposals.
- ★ Because of its relationship to economic growth and poverty reduction, gender equality is a priority area for MCC. To reflect this priority, and to complement MCC's Gender Policy, MCC has developed detailed **Guidance on Gender Integration** and has incorporated gender integration aspects into other compact guidance documents.

All guidance related to these compact development steps is available on MCC's public website.²

Focus on Results and Performance of the First Compact

MCC and country counterparts will consider the available actual and expected results and implementation performance in the first compact throughout the development and implementation process for a potential second compact:

- ★ Available results data from the first compact will be presented to the MCC Board to review during the **country selection** process for second compact eligibility.
- ★ Concept papers submitted for sectors that were part of the first compact must include an analysis of actual and expected results, planned versus actual timeline, and other **lessons learned** from the first compact. Proposals must address how risks encountered during first compact implementation, including environmental and social issues, will be mitigated.
- ★ MCC's decisions regarding viable concept papers and its **project development and appraisal** process will be informed by evidence available from actual and projected results and the track record of first compact implementation, including performance on meeting compact conditions and compliance with MCC guidelines.
- ★ In determining proposed **project costs**, MCC and country partners will include careful analysis of the factors that influenced final project costs during first compact implementation, especially in cases where actual project costs exceeded estimated budgets.

² <http://www.mcc.gov/pages/countrytools/tools/compact-development>

- ★ As additional first compact information becomes available, including through post-compact assessments and impact evaluations, MCC and country partners will use this use data to inform project proposal assessment, **project design** and implementation approaches.

3. Compact Partnerships

MCC expects to see an evolution in the nature of its relationship with second compact countries. MCC expects second compact country partners to build on their previous experience working with MCC and reflect a clear understanding of MCC’s model and approach. MCC expects that this will translate into quick mobilization of a core team for second compact development, streamlining of the compact development process relative to the first compact, project proposals that are a good match to MCC’s model, and explicit incorporation of lessons learned from first compact implementation. MCC also expects second compact country partners to commit significant country resources in compact development and implementation, and to manage a robust consultative process that places increased emphasis on seeking compact partnerships with the private sector, other donors, and civil society organizations.

Compact development core team

Consistent with MCC’s guidance document “Characteristics of a Core Team,” country counterparts are responsible for project design and compact development. Second compact eligible countries must support a core team focused exclusively on the second compact. It is important to draw lessons learned from implementation of a first compact, and incorporate those lessons into the development process. However, completion of the first compact is the top priority for first compact MCA staff, and first compact funds cannot be directed toward second compact development. Therefore, first compact MCA staff currently engaged through MCC funding can only serve in an advisory capacity regarding second compact development. For example, this might include providing relevant program documentation including monitoring and evaluation data, sharing implementation lessons from projects relevant for second compact development, and providing feedback on proposed implementation approaches based on first compact experiences.

Resources for compact development

Country contributions during compact development and implementation are critical, because such contributions promote ownership, demonstrate commitment, provide for more meaningful and equitable partnerships, and reflect responsible MCC management of scarce public resources.

All compact-eligible countries hold responsibility for leading and mobilizing funding for the compact development process. In addition to supporting the compact development core team, each country must undertake extensive public consultation and a range of economic, technical, social, gender and environmental studies during the

preparation and appraisal of concept papers. Countries eligible for second compacts will be expected to identify and commit significant resources to manage and fund the compact development and appraisal process. MCC provides support to this process through MCC's technical and country relations staff, as well as consultants hired directly by MCC. In addition, MCC may enter into contracts on behalf of, or make grants to, any compact eligible country for the purpose of facilitating the development and preparation for implementation of the compact between the United States and the country, through MCC's 609(g) authority. This funding has been used for feasibility studies, environmental and social impact analysis, and detailed design work. All countries receiving 609(g) funding are required to provide, at a minimum, facilities, logistical support, data, and other resources to work with MCC staff and consultants throughout the project development and appraisal process.

Resources for meeting compact objectives

MCC already requires lower middle income countries to identify a contribution toward meeting the objectives of the compact during compact implementation. This contribution should be in addition to government spending allocated for such purposes in the country's budget for the year immediately preceding the establishment of the compact, and should continue for the duration of the compact.

As with the compact development process, all second compact eligible countries will be expected to identify and commit significant resources to be contributed during the compact implementation period. Countries in the low-income country category are expected to contribute 7.5% of the total compact amount to meeting compact objectives. Countries in the lower-middle income category are expected to contribute 15%. These contributions should be focused on supporting improved performance towards or sustainability of compact objectives. MCC will work with its counterparts to identify and estimate the value of these contributions, with the goal of maximizing the benefit from available resources without introducing excessive complications. MCC has a strong institutional interest in country contributions that will have long-term impact in terms of development results and sustainability of MCC-funded investments.

Private sector engagement and innovation

MCC recognizes that the non-governmental sector – including the private sector (international as well as domestic, small- and medium-sized as well as large), foundations, philanthropic and social responsibility funds, non-governmental organizations (NGOs), and international financial institutions – must play a key role in economic growth and poverty reduction, particularly in regard to the sustainability of investment impact and the efficient mobilization and application of capital. Increasing private sector engagement has been identified as one of MCC's core priorities. Consideration and, where feasible, inclusion of private sector partners and strategies for private sector development are expected to be factors in the development and implementation of compact programs.

MCC will be seeking evidence that, at a minimum, private sector-led or directed strategies have been considered as part of the compact development process.

Alongside encouragement of broad types of partnerships focusing on program design and delivery, MCC is also interested in encouraging a broad range of financing instruments, such as guarantees and other risk-sharing instruments, investment facilities, output-based aid, performance contracting, parallel financing, matching grants, first loss facilities, etc. MCC is also interested in innovative program content, including the application of new and appropriate technology. These types of instruments and program content can be used if they follow logically from the identification and analysis of constraints to growth, are part of projects that have promising returns in terms of poverty reduction and economic growth, and have the potential to increase the impact and/or sustainability of MCC funded investments.

MCC's *Guidance on Private and Non-Governmental Sector Engagement* can be obtained through www.mcc.gov.