

Overview of the Compact Development Process

Compact development is vital to MCC's operations as it defines the content of compact investments, establishes relationships with country counterparts and sets the stage for the success or failure of compact implementation. The following guidance, revised as of January 2012, provides MCC staff and their country counterparts with instructions, lessons learned, templates, and other material to assist with the development of a compact agreement.

Countries developing compacts should keep a number of key principles in mind:

- ★ **Poverty Reduction through Economic Growth:** MCC's goal is to assist partner countries to reduce poverty through economic growth. MCC's compact development process is designed to achieve this by focusing on a country's key constraints to economic growth and poverty reduction. MCC believes a country's development is sustainable only if aid is eventually replaced with private sector-driven economic activity that protects environmental capital and advances social equality.
- ★ **Smart Public Policy:** Smart public policies provide the foundation for sustainable economic growth and poverty reduction. MCC focuses on incentivizing smart public policy throughout the compact development process, beginning with country selection, which is focused on democratic developing countries that rule justly, invest in their citizens, and promote economic freedom. Eligible countries must maintain good policy performance on MCC's selection criteria to remain eligible for MCC assistance during compact development. During compact development, MCC assesses the policy and institutional environment for proposed projects and may require or directly support policy reforms in order to ensure compact investments are sustainable.
- ★ **Partnership and Country Ownership:** Eligible countries are asked to demonstrate leadership and a high level of commitment throughout the compact development process. Eligible countries are responsible for identifying the greatest constraints to economic growth, ensuring civil society participation, and investing necessary resources to develop a compact. MCC will act as a partner and advisor throughout the process.
- ★ **Achieving and Sustaining Results:** Compact-eligible countries must have well-designed compacts with clear objectives, benchmarks to measure progress, clear fiduciary oversight over the use of MCC assistance, and a plan for effective monitoring and objective evaluation of compact program results. Compact projects should be designed to be financially and technically sustainable once MCC funding has ended.
- ★ **Focused Compact Investments:** Over time MCC has learned that overly complex, geographically dispersed compact programs create elevated risks and are extremely difficult to manage. Countries are encouraged to be mindful of their own management and oversight capacity when designing compact programs.

Summary of the Compact Development Process

The figure below provides an illustrative summary of the compact development process, along with the 27 month target timeline to reach compact signing.



Phase 1: Start-up and Preliminary Analyses

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

- ★ **Country Core Team:** Countries should take the necessary steps to recruit and adequately fund an MCA country core team (core team) led by a full-time Compact Development Coordinator to lead the country’s compact development process and to manage its day-to-day relationship with MCC. The Coordinator should be empowered to run the compact development process, enjoy a high level of political commitment, and have 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 towards a 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, social and gender analysis, sector specialists, project development and management, financial management, procurement planning and legal counsel. Some core team positions (economists, social scientist with gender expertise) have critical functions very early in the process.
- ★ **Constraints Analysis:** The country should conduct an analysis of the principal constraints to economic growth and poverty reduction, and, if appropriate, more detailed sector analyses. The target timeframe for completion of the constraints analysis is within three months of country selection.
- ★ **Social/Gender Inequality Analysis:** Social inequality, including gender inequality, can limit poverty reduction even in the context of growth. Following the economic constraints analysis, MCC and the core team, led by their social/gender expert, will analyze how social inequalities expressed in policies, institutions, and other sociocultural contexts can constrain poverty reduction and recommend actions to correct and/or mitigate their impact.
- ★ **Investment Opportunity Analysis:** Following the identification of binding constraints to economic growth, the core team and MCC will conduct an analysis to ensure that opportunities to enhance and leverage the level of private sector activity are explored and given appropriate consideration during compact development. At its core is the aspiration to leverage private sector views, expertise and, in some cases, capital to enhance compact outcomes.
- ★ **Consultative Process:** The country should initiate a timely, participatory, and meaningful consultative process with the country’s civil society, non-governmental organizations and private sector, as well as a broad range of government stakeholders, to discuss further key constraints to economic growth and poverty reduction, and to identify priority activities to help address these constraints. Please refer to our summary of the key elements of the consultative process through all phases of compact development.

Phase 2: Project Definition

Project Concept Notes

Shortly after the first draft of the constraints analysis, MCC should provide the country core team with up-front guidance and coaching regarding MCC's investment criteria, as well as an illustrative list of MCC projects done to date, projects MCC has rejected, and why. On the basis of this guidance and more intensive, sustained dialogue with MCC (including coaching by technical sector staff on critical aspects of MCC's requirements in key functional areas that country counterparts need to understand), countries will begin the process of project selection.

On the basis of this guidance, countries should provide MCC with notes (not to exceed five pages) outlining potential projects for consideration. These concept notes should provide MCC with an initial outline of basic project characteristics, including a project description, economic logic linked to unlocking an identified constraint to growth, whether feasibility or design studies already exist, and whether the project builds on or complements existing government or donor projects. The purpose of the concept notes is to identify the pool of potential projects in country, facilitate earlier project appraisal by MCC, and earlier engagement of MCC technical staff in order to determine which project concepts are viable enough to develop more comprehensive project concept papers.

Project Concept Papers

Based on the constraints analysis, analysis of social/gender inequalities, and investment opportunity analysis, initial stakeholder consultations, and MCC's technical assessment of the concept notes, the core team then analyzes more thoroughly specific problems and opportunities to identify possible projects for MCC funding through more detailed project proposals, called project concept papers.

Project concept papers describe for each proposed project: (i) project rationale, activities, and costs, (ii) sector context and policy, institutional, legal and regulatory environment, (iii) existing preparatory work, such as feasibility and design studies, (iv) an analysis of the costs and benefits, and beneficiaries, (v) environmental, social and gender opportunities and risks, (vi) mechanisms in place or contemplated to ensure financial and technical sustainability, and (vii) proposed implementation arrangements.

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 substantial time and resources are invested into full project development;
- ★ Informing detailed discussions between MCC and the candidate country 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 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.

In order to enhance the quality of the project concept papers, MCC has adopted the *Results Focused Project Design and Logical Framework* methodology used by the Asian Development Bank and other donors. Core teams are encouraged to use this or similar results-focused approaches to analyze and describe projects. The objective of this methodology is to provide a clear analysis of the economic problems the compact intends to solve, and the alternative courses of action considered. The methodology also relies on focused stakeholder consultations, as well as consideration of current and expected assistance provided by other donors, the role of the private sector, and public sector financing. Further, the analysis will include an assessment of how gender and other social differences and inequalities contribute to opportunities and constraints for poverty reduction through growth. MCC should provide assistance to the core team during the project definition phase, including advice and examples on how to integrate the private sector into compact activities through public-private partnerships or other means.

Concept Paper Assessment and Peer Review

Upon receipt of project concept papers, MCC undertakes an initial assessment of them, conducts an internal and external peer review, and prepares the concept assessment memorandum, which once cleared by MCC senior management is transmitted to the partner government.

1. Initial Concept Paper Assessment: The transaction team conducts an initial assessment of the project concept paper, and on the basis of its analysis provides 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 transaction team's assessment focuses on a range of project questions, including:
 - * *Rationale:* MCC staff will assess the following questions: Is the project rationale sound? Does the project address a key constraint to growth? Will it lead to poverty reduction through a set of clearly defined project outcomes resulting from project outputs generated through investments in specific activities? Will the project displace or crowd out private investment? Does the project complement rather than duplicate the activities of other major donors?
 - * *Expected Impact:* MCC economists will review the economic analysis provided by the country core team, and prepare if necessary an initial economic rate of return 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 project's viability. A more sophisticated model will be developed for those projects that MCC and the country agree to pursue. Questions will include: Do the benefits sufficiently outweigh the costs? Does the preliminary economic analysis provide a rate of return above an established hurdle rate, based on internationally accepted models for benefit-cost analysis? Do substantial benefits flow to the poor?
 - * *Sustainability:* Is the project sustainable? Is the project concept supported by national policies, institutions and practices that will ensure the financial sustainability of investments? Will the legal and regulatory framework allow the project to continue to provide benefits in the future? Does the government have the technical capacity to operate and maintain the project after the conclusion of the compact?
 - * *Environmental, Social and Gender Issues:* Does the project enhance environmental or social benefits, or enhance the sustainable use of natural resources? Does the project contribute to or remove barriers to social and gender equality? 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?
 - * *Implementation Risk:* Can the project be implemented in five years? Do the institutions that are proposed to implement each project have the demonstrated capacity to manage the project? Can the scope and complexity of work 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 senior management and Board of Directors?
2. Peer Review: Once the transaction team has conducted its initial analysis, it will share that analysis both within MCC (e.g., within practice groups) and to outside experts (e.g., in a particular technical area) to ensure that MCC's analysis is sound and technically accurate. Outside expertise can also assist MCC in technical or regional areas outside the existing knowledge base of MCC staff.
3. Recommendation: Following internal and external peer reviews of MCC's initial concept assessment, the transaction team prepares a concept paper assessment memorandum for approval by MCC senior management. Upon approval of that memorandum, the transaction team will prepare a letter to the government and core team outlining MCC's decisions and next steps. It is important to note that a decision by MCC to support further project development does not constitute a commitment to finance proposed projects.

Phase 3: Project Development and Appraisal

Project Development: Generally, MCC staff will travel to the country to review the concept paper assessment memorandum with the 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 consists of the completion of requisite project preparatory studies including, *inter alia*, feasibility and preliminary design studies, environmental, social and gender assessments, and economic and

beneficiary analyses. Whether project development studies are funded by the country or through 609(g)¹ grants, the MCC 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 planning, design and preparation of project implementation structures and arrangements.

In some cases, it will not be possible to complete all planned studies for all projects prior to submission of the overall compact program for MCC Board approval. Nonetheless, every effort should be made 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.

609(g) Funding: When countries require financial assistance to undertake additional preparatory studies, MCC can provide limited financial support using 609(g) funds. Either MCC will administer these funds on behalf of the recipient country or the recipient country will administer the funds, including by procuring technical expertise using MCC's *Program Procurement Guidelines and then managing the contracts*. During compact development, MCC expects to provide less 609(g) funding to lower middle income countries and countries pursuing a second compact than to low income countries and countries seeking their first compact.

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. These and other implementation preparation activities are described in more detail in the *609(g) policy* in this guidance.

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 an internal peer review panel. At this stage MCC and the 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 project appraisal process. Where detailed assessments identify fatal flaws that cannot be mitigated through such modifications, MCC may decide to remove the proposed project from further consideration.

Phase 4: Investment Committee, Compact Negotiation and Signing

Once project appraisal is completed, the transaction team prepares an investment memorandum that describes the proposed projects to be funded under the proposed compact. This memorandum is submitted to MCC's Investment Management Committee for approval. If the Investment Management Committee approves the proposed compact projects, the draft compact and other legal documents will be prepared. Before MCC enters into negotiations with a country on the proposed compact program, MCC must inform Congress of its intent to negotiate a compact through a congressional notification. If there is no Congressional objection, MCC and the country may conduct negotiations on the compact and other legal documents. Thereafter, the compact is submitted to the MCC Board for approval and if approved, MCC and the country sign the compact.

Phase 5: Implementation Preparations / Pre-EIF Activities

Implementation preparations must begin well before compact signing. Building the compact implementation framework is a key component of these preparations and includes the formation, staffing and start-up of the MCA accountable entity (including its board of directors and management unit), the engagement of procurement and fiscal agents, establishment of banking arrangements, and the procurement of project managers and certain key contractors. MCC may finance or facilitate implementation training in the following areas:

- ★ Financial management
- ★ Accounting
- ★ Auditing
- ★ Budgeting
- ★ Procurement
- ★ Project management

¹ The term "609(g)" refers to a section of the Millennium Challenge Act of 2003 that authorizes MCC to provide funding to facilitate compact development and implementation.

- ★ Ensuring gender integration
- ★ Managing environmental and social performance
- ★ Monitoring and 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
- ★ Development of Gender Integration 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 and Procurement Operations Manual
- ★ 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

Compact Development Timeline

Compact development is not an open-ended process. While MCC is committed to developing quality, high-impact projects through its compact development process, it must also be a responsible steward of U.S. taxpayer funding, including by ensuring the funds are employed in a reasonable amount of time after appropriation by the U.S. Congress. **The compact development process should take 27 months² from selection by MCC's Board to compact signing. Any extensions to this timeline must be approved in writing by the Vice President for Compact Operations.** MCC will work closely with partner countries to reach this goal by setting clear milestones in the compact development process. Following the constraints to growth analysis, some compact development processes may move in parallel in order to save time. For example, for countries selected by the Board in December 2011, the compact development timeline would be as follows:

- ★ Phases 1 & 2: Start-up, preliminary analyses and project definition: Five months (December 2011 - May 2012)
MCC begins initial country analysis prior to Board meeting for countries likely to be selected. MCC schedules initial visit. Partner country appoints key Compact Development Coordinator and staffs core team, including specialists with required expertise in economic and social/gender analysis. Together, MCC and core team conduct analysis of constraints to economic growth, followed by analyses of investment opportunity, social/gender inequalities, and deeper constraints in key sectors if required.
The core team also conducts consultations with relevant government and public stakeholders and determines sectors for potential project concepts. Following these analyses, project design workshops and additional targeted stakeholder consultations, the core team drafts initial project proposals (concept notes) for MCC review. Following MCC's review of the concept notes, the core team conducts results-focused project design workshops or other targeted stakeholder engagement, surveys potential projects, and drafts and submits concept papers to MCC.
- ★ Concept paper assessment: Two months (May 2012 – July 2012)

² The 27 month target is a ceiling, and countries may take less than 27 months to develop a compact.

MCC transaction team performs a preliminary assessment of concept papers, conducts a peer review, and drafts a concept paper assessment memo with recommendations for MCC senior management.

- ★ Phases 3 & 4: Project development and assessment; compact negotiation and signing: 20 months (July 2012 – April 2014)

MCC transaction team and core team jointly develop a work plan based on the nature of projects, level of project preparation, and availability of staff and other resources. MCC conducts due diligence and works with countries to carry out feasibility studies, economic rates of return, social and environmental assessment work, and to define the final scope and results of projects. MCC transaction team drafts investment memorandum for approval by MCC's Investment Management Committee. MCC transaction team works with core team to plan implementation structures and timelines. MCC negotiates and finalizes compact with country. Compact is signed.

To incentivize earlier core team staffing, selection of well-prepared projects, and strong performance during the compact development process, MCC senior management may decide to make additional 609(g) funds available. Should countries slip substantially from their agreed timeline, MCC may also revisit decisions about projects it will support or funding it is willing to provide.

Compact Development Budget

Compact transaction teams, led by a Transaction Team Leader, will be required to formulate and submit for approval a compact development budget to the Vice President for Compact Operations. This budget will consist of expected due diligence, 609(g) and administrative (e.g., personnel and travel) costs over the course of compact development, up to a compact's entry into force. The budget shall be submitted within two weeks of selection by the MCC Board, with updates as necessary once projects are identified and due diligence has begun.

Compact Development Best Practices

Over the course of the development of 24 compacts, MCC has learned the following best practices in order to ensure a successful compact:

High-Level Political Commitment

Eligible countries that have demonstrated a high level of political commitment to the core team and compact development process have progressed more rapidly in developing their projects and finalizing compacts. Core teams also benefit from having access to senior government officials who can quickly make decisions.

Dedicated Human and Financial Resources

Eligible countries that have quickly identified a Compact Development Coordinator and have established and adequately financed a core team of dedicated, qualified staff have also moved more quickly. Such a team is necessary to effectively integrate input from a broad range of key stakeholders both within and outside of government and to identify technical resources as necessary. Further, dedicated financial resources have strengthened the quality of project development and design.

Manageable Programs

Compact programs should be within the manageable control of the country. While managerial capacity will vary from country to country, MCC should conduct discussions with other donors about the country's management capacity, performance to date managing public and donor funding in different sectors, and capacity to take on new project management responsibilities.

Think Early About Implementation

Eligible countries will likely be able to move more rapidly through the final stages of project development and compact negotiations if they integrate implementation planning into their thinking earlier on, such as: how the project will be implemented, managed, monitored and evaluated; how funds will be managed; and how goods and services will be procured. Developing documents such as workplans and budgets early in the process will assist in identifying suitable arrangements. MCC recognizes the importance of providing compact eligible countries with clear guidance on the standards on which their projects will be evaluated. MCC has, and will continue to develop, guidance on key issues and make them available to partner countries and the public on the MCC website.

Think Early About Economic Analysis and Measurable Results

Compact-eligible countries will likely be able to move more rapidly through the final stages of project development and compact negotiations if they integrate economic analysis and measuring results into their thinking early on, including: is there a clear economic logic, relating to unlocking an identified constraint to growth, to the proposed project? What is the potential economic rate of return and what drives it? What are the project goals? What are the expected results? How will we know if this has been successful? What data would we use to measure progress and is baseline data available? Have targets for measuring success been defined up front? Who will be responsible for collecting data, monitoring results and evaluating performance?

Think Early About the Impact of Social/Gender Differences and Inequalities and Developing Gender Integration Plans

Eligible countries are encouraged to give early analytical attention to social inequalities, like gender, that can be significant constraints to poverty reduction. Inequalities that do not disappear with growth can reproduce poverty and inhibit development over time. Countries that ensure sufficient social/gender expertise and analysis are brought to the design process to ensure that they are able to meet the MCC requirement for a Gender Integration Plan early in implementation.

Technical Feasibility

In addition to qualitative aspects of a project design, MCC evaluates a number of technical elements during the appraisal phase of compact development to determine whether it is sound investment: is the project technically viable? Is the design appropriate? Is the policy environment suitable? Is the cost estimate correct? How is the project going to be sustained? What are the potential environmental and social impacts, including resettlement and health and safety? How has analysis of gender differences and inequalities informed project selection and design? These evaluations are a necessary part of an iterative appraisal process and are generally carried out through multiple visits by technical experts. To the extent possible, MCC strives to communicate its requirements in advance so that countries can better prepare for technical visits.

Quality Consultative Process

Eligible countries that have focused on conducting a timely, participatory, and meaningful consultative process — which provides both women and men with the opportunity to have input into the identification, prioritization and subsequent development and design of projects — have greater success in project development. Maintaining an ongoing dialogue throughout compact development and implementation allows for more sustainable efforts.

Early and Continuous Dialogue

Eligible countries that have proceeded most quickly through the compact development process engaged with MCC early in the process and have maintained a regular dialogue. Regular communication can come in the form of face-to-face meetings, conference calls and email. An engaged Ambassador to the United States, who is kept informed by both MCC and the eligible country, can be an important contributor to clear and regular communications which may help facilitate the process.

Pre-Compact Assistance

MCC can, where appropriate, provide eligible countries with pre-compact financial assistance (often referred to as “609(g) funding”) to facilitate compact development.

Overview of Compact Development



