

**THE MILLENNIUM CHALLENGE CORPORATION:  
A PROGRESS REPORT**

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**HEARING**

BEFORE THE

**COMMITTEE ON FOREIGN RELATIONS**

**UNITED STATES SENATE**

**ONE HUNDRED EIGHTH CONGRESS**

**SECOND SESSION**

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OCTOBER 5, 2004  
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**TUESDAY, OCTOBER 5, 2004**

U.S. SENATE,  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, DC.*

The committee met, pursuant to notice, at 10:05 a.m. in room SD-419, Dirksen Senate Office Building, Hon. Richard G. Lugar (chairman of the committee), presiding.

Present: Senators Lugar, Hagel, Alexander, and Feingold.

OPENING STATEMENT OF SENATOR RICHARD G. LUGAR, CHAIRMAN

The CHAIRMAN. This hearing of the Senate Foreign Relations Committee is called to order. Today the Senate Foreign Relations Committee meets to receive a progress report on the Millennium Challenge Corporation and we look forward to the testimony of our witness, Mr. Paul Applegarth, who is the Chief Executive Officer of the MCC. The MCC is charting an innovative course in development assistance. Our committee has enthusiastically endorsed the concept of this new organization, which will provide assistance to developing countries that invest in their people, uphold political freedoms, fight corruption, maintain the rule of law, and pursue sound economic policies.

We want to ensure that the MCC becomes an efficient and valuable tool of U.S. foreign policy. We want it to be a bold weapon in the battle against poverty, disease, corruption, disorder, and terrorism. We want the MCC to help lift deserving nations and provide incentives for meaningful reform in countries around the world.

The performance of the MCC during the next 6 to 12 months will determine whether it can fulfill this ambitious vision. During that period the MCC will operate in a difficult political and budgetary environment. In recent years, Congress has demonstrated a parsimonious attitude toward the 150 account, which funds foreign assistance, embassy operations, cultural and educational programs, contributions to international institutions, and many other aspects of our outreach to the world. It has significantly cut the President's request for the 150 account for 2 years in a row.

This year, President Bush proposed a healthy 8 percent increase for the foreign affairs portion of the budget. The Senate Budget Committee cut the President's request by a billion dollars. On the Senate floor, I offered an amendment to restore the cut, and that

amendment succeeded. But the House Budget Committee cut the President's request by \$4.6 billion. The resulting budget conference settled on a compromise that would trim more than \$2 billion from President Bush's request.

Thus, Congress is doing, in my judgment, the unthinkable—downsizing the President's foreign policy budget request at a time of our greatest diplomatic crisis in decades. This is the equivalent of cutting the defense budget in time of war. Responsibility for this untimely action is unfortunately bipartisan and bicameral.

By downsizing the President's 150 account requests, Congress has ignored the fact that foreign affairs spending has not yet recovered from extreme cuts implemented in the 1990s during the era of peace dividends. In constant dollars, the foreign affairs budget was cut in 6 consecutive years from 1992 to 1998. This slide occurred even as the United States sustained the added costs of establishing new missions in the 15 emergent states of the former Soviet Union. In constant dollars, the cumulative effect was a 26 percent decrease in our foreign affairs programs. As a percentage of GDP, this 6-year slide represented a 38 percent cut in foreign affairs programs.

By the end of the decade, these cuts had taken their toll. The General Accounting Office reported that staffing shortfalls, lack of adequate language skills, and security vulnerabilities plagued many of our diplomatic posts. Meanwhile, after decades of being the largest provider of economic aid to the world, the United States fell behind Japan throughout the period between 1993 and 2001, even though our gross domestic product is almost three times greater than Japan's and our international interests are more expansive.

In the year following the September 11 attacks, President Bush and Secretary Powell prevailed upon Congress to boost foreign affairs spending. We began the process of filling the budgetary hole that we had dug for ourselves in the 1990s. But Congress's reductions in the President's requests during the last 2 years have impeded this progress. As a percentage of gross domestic product, foreign affairs programs are still about 40 percent below their average levels in the 1980s.

Not every problem can be solved with more resources. But Congress must understand that we are in a race to secure our future. We are in a race to safeguard weapons and materials of mass destruction; and to overcome anti-American opinion in dozens of nations around the globe; to gain cooperation in the war on terror and to combat poverty, disease, and economic hopelessness. These are life and death issues on which the security and moral authority of our country rest.

In the best case, Congress will reconsider and give the President and the Secretary of State what they need to fully restore U.S. diplomatic and foreign assistance capabilities. I will continue to argue for this outcome with like-minded colleagues on this committee and elsewhere in Congress. But in the absence of enlightened 150 account increases, the MCC will be competing for scarce funds with other deserving foreign policy programs.

In this competition, the MCC enjoys the advantage of being the President's initiative, but this sometimes can turn into a disadvan-

tage. My hope is that the MCC will perform so well during the next year that Members of Congress of both parties will embrace it enthusiastically as an inspired idea and an essential program. But for this to happen, the execution of the MCC concept must be truly extraordinary. Compacts must be concluded and money must be spent quickly, while ensuring that those dollars are distributed fairly, effectively, and without corruption.

This committee has held multiple hearings on the loan practices of multilateral development banks and on reconstruction spending in Iraq, both of which have suffered from severe management flaws. In the case of the MDBs, loans have frequently been made with insufficient oversight, leading to corruption and waste. In the case of Iraq, critical reconstruction funding has been stalled by bureaucratic red tape, a cumbersome approval process, and an insufficient sense of urgency. The MCC must avoid all of these problems.

President Bush has pledged to seek \$5 billion for the MCC in its third year of operation, which will be 2006. This committee authorized \$1 billion for 2004 and \$2 billion for 2005. I am hopeful that appropriators will find a way to increase funding for the MCC. I have written to the Bush administration to urge that they act decisively on behalf of increasing funds for the MCC in this fiscal year. Mr. Applegarth, we look forward to a report on MCC expenditures thus far.

The United States will be writing compacts with MCC countries after consulting with them on their ideas of how best to stimulate growth and eliminate poverty. This dialog is a crucial component of the MCC concept. We look forward to an update on the compact development process, and we are especially interested in knowing how the MCC is ensuring broad civil society participation in the drafting of country proposals.

We are also eager to know your timetable for completing compacts. In the last 8 months I have had to build an entire organization from the ground up, solidify the MCA's procedures, and develop criteria for selecting eligible countries. You have done a lot in a short period. However, we are anxious to see actual compacts signed. Do you anticipate that any compacts will be completed and any funding distributed by the end of this calendar year? If not, when will the first compact be completed, and is there any way to accelerate the process while maintaining requisite standards of operation?

We are also interested in your thoughts about the threshold program, which is intended to provide targeted assistance to help near-miss nations qualify in the future. This joint venture with USAID is a critical component of the MCC mission. It was encouraging to hear Secretary Powell say during a recent hearing that many countries are coming to us asking what they have to do to get into this program. This enthusiasm may spur new efforts toward reform around the world. To this end, we need to maintain the right incentive structure for countries interested in becoming MCC countries. The continued transparency of indicator policy, selection methodology, and compact development is critical to the overall success of the MCC.

The MCC holds great promise for both participating countries and the United States. It gives us a chance to invigorate our rela-

tionship with the developing world and help set those countries on a course of progress. We hope that the MCC, working closely with Congress, can realize the original vision of President Bush to dramatically expand our ability to spur economic development throughout the world.

Let me welcome our colleagues to the hearing and ask if in fact any of our colleagues have additional opening comments that they would like to make. Senator Feingold?

Senator FEINGOLD. Mr. Chairman, just very briefly, I thank you very much for having this hearing. Mr. Applegarth, it is good to see you again.

As you know, I believe that the President's Millennium Challenge Account initiative is an admirable one. It recognizes two important facts: that sustainable development overseas is in our national interest and that development efforts are most likely to succeed in countries that are actually taking serious steps to get their own fiscal houses in order, to crack down on corruption, to respect the rule of law and basic human rights, and then to invest in their own citizens' well-being.

As I am sure you are already experiencing and have experienced before, good ideas are not always easy to implement. A lot of people are skeptical about creating a new institution to implement this initiative. I for one have not yet heard concrete plans for how the Millennium Challenge Corporation plans to monitor and evaluate U.S. taxpayer-funded projects overseas.

I also want to be sure that resources for very valuable existing programs are not used in order to fund this. My understanding is this was to be on top of other things that we believe strongly in, and I would have some questions about that as well. But I am eager to hear how it is going and I very much appreciate your being here.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Feingold.

Senator Hagel, do you have an opening statement?

Senator HAGEL. No statement.

The CHAIRMAN. Senator Alexander.

Senator ALEXANDER. Thank you, Mr. Chairman. I have a statement I would like to put in the record and I would like to say these things.

First, I fully support what Chairman Lugar said. I support the Millennium Challenge Account. It is a bold new approach. I hope we as a Congress can appropriate at the level that the President has asked for, and I also sent a letter to our committees along with some other Senators urging that.

The one thing I would like to suggest is you have 16 countries qualified for funding and another 7 who came close. Temptation in government in some quarters would probably be to give everybody a little bit, but it is my hope that, especially in this first round, that the money go to fully fund the best projects. I will be supporting you on that if that is the decision that you make, even though that means that some pretty good projects do not get funded because there is not enough money in the first round. But it is very important that the first projects be the best projects and that



they have the best chance of success in setting a good example for the future.

Thank you, Mr. Chairman.

[The prepared statement of Senator Alexander follows:]

PREPARED STATEMENT OF SENATOR LAMAR ALEXANDER

Millennium Challenge Accounts represent a bold new approach to foreign aid. If properly executed, it should prove quite successful. The principle is simple: reward poorer countries that have established sound policies, giving them the needed boost to achieve the next level in their nation's development. The result is a double bonus: we're providing incentive for good policy choices by rewarding them, and we're providing aid where it is most likely to do good—in those countries that already have the right policies in place. By rewarding poorer countries that put an emphasis on open markets and the rule of law, we will help put more countries on the path to prosperity.

That's why earlier this year I sent a letter—that was also signed by Senators Santorum, Sununu, and Sessions—to appropriators asking them to appropriate as nearly as possible the amount requested by the President for this important initiative. I'm sorry to report that both the House and Senate came up short. The House version of the Foreign Operations Appropriations bill funds only half the President's request, and the Senate version even less. I hope conferees on the bill will do better, but I'm not optimistic.

At the same time, we also need to see some positive results coming from the Millennium Challenge Corporation. To date, no money has been awarded, and the MCC is still severely understaffed. We need a success story. Unless Congress can see an example of the MCC working—efficiently and effectively—we are unlikely to fund the MCC to requested levels.

To that end, I hope the MCC will remain true to its purpose: to provide a relatively large sum for major projects in a few qualified countries. Sixteen countries qualified for funding under the MCC this year, and another seven threshold countries, who came close to qualifying, were announced last week. I'm pleased that eight of the sixteen and four of the seven are in sub-Saharan Africa. The temptation will be to fund qualified projects in all those countries. While I sympathize with that desire, given that the MCC has been severely under-funded to date, we should not give in to that temptation.

Rather, the best projects in a few of the qualified countries should be fully funded. That may not seem fair to every country that has qualified, but it will ensure that Millennium Challenge Accounts achieve the desired impact—greatly improving a few qualified countries so they can rise up to the next level of development. If the MCC chooses to sprinkle its limited funds around all the qualified and threshold countries, the impact will be greatly diminished and the program will end up looking more like our traditional foreign aid programs rather than a new, bold initiative.

The CHAIRMAN. Thank you very much, Senator Alexander.

Mr. Applegarth, we deeply appreciate your patience in waiting for our votes to happen. We believe that we have clear sailing for a good period of time ahead of us before votes will recommence. We look forward to your testimony as well as your responses to all of our questions, but even more we appreciate the enthusiasm and idealism which you bring to this program.

Will you please proceed. Let me say your full statement will be made a part of the record. You may either recite from that or summarize as you prefer.

**STATEMENT OF HON. PAUL V. APPLGARTH, CHIEF EXECUTIVE OFFICER, MILLENNIUM CHALLENGE CORPORATION**

Mr. APPLGARTH. Thank you, Mr. Chairman and members of the committee, for the opportunity to address you today. Because we do have a lot to discuss, I have submitted a written statement for the record and will just summarize it this morning.

My opening remarks address several of the questions that you all raised in your own opening remarks. To the extent that they do not, and it does not, I would like to address them during the Q&A session.

Sixteen months ago I was testifying before you as President Bush's nominee to become the first Chief Executive Officer of MCC. During these past 6 months, the MCC has designed and implemented its operating structure, carefully reviewed and selected countries that are eligible to formally apply for fiscal year 2004 assistance, and announced the first threshold countries. And at this moment we are evaluating the first proposals and concept papers that have arrived from 13 of the 16 selected countries.

As the committee is well aware, it was only on January 23 of this year, with sustained bipartisan support, that MCC was established as a unique and innovative effort in poverty reduction and sustainable development. Underlying all our efforts is a pronounced emphasis on policy reform. We believe that by providing incentives for countries to adopt policies for governing wisely, investing in their own people, and promoting economic freedom, we strengthen the critical relationship between fundamental democratic principles and economic freedom, that together form the bedrock of stable and responsible nations.

MCC is unique because it was deliberately designed to make U.S. aid more effective by linking increased foreign assistance to good governance and sound policies. As you mentioned, Mr. Chairman, MCC is innovative in several important respects. Countries are selected based on their ability to participate as full partners in the development process. This genuine process means that they themselves will design programs that directly address the root causes of poverty and will stimulate economic growth in those areas that they determine are most important.

Since January 23, MCC has set ambitious goals for itself, moving as fast as the legislation allowed. On May 6, MCC's board of directors selected the first 16 countries eligible to submit proposals for MCC assistance. These 16 countries, which when combined represent more than 130 million people, were selected out of 63 of the poorest countries in the world. The selection was based on published criteria, including 16 indicators developed by the World Bank, Freedom House, and other entities independent of the U.S. Government. They rank countries on whether they are governing justly, investing in their own people, and encouraging economic freedom.

MCC has already announced the names of 71 candidate countries for fiscal year 2005. We expect our board to select the 2005 Millennium Challenge Account-eligible countries next month.

It is important to point out that since the fiscal year 2004 selection criteria and methodology were announced MCC has received a number of very valuable public comments. These comments were taken into account during our review of the selection criteria for fiscal year 2005. For example, in a direct response to public comments MCC replaced the primary school completion rate indicator, which measured graduation rates for all students, with a girls primary school completion rate indicator. We made the change to emphasize clearly the proven importance of primary education for

women in terms of poverty reduction and growth and because data is now available to provide a measurable ranking.

MCC is also exploring potential improvements in the selection criteria for the future, such as measuring the country's support for entrepreneurial activities, improved focus on investing in people, and the economic cost of trade barriers. We are also establishing a working group to help identify an indicator to measure a country's policies as they affect its natural resources. This group will be chaired by MCC Board Member Christie Todd Whitman.

Within 3 weeks of the selection of the first round of MCC-eligible countries in May, we had MCC teams on the road to visit all the countries. Working together with USAID and embassies, we explained to a wide variety of groups in each country that we wanted each nation, through a consultative process with civil society and the private sector, to develop a compact proposal, which is essentially a detailed implementation plan that lays out country priorities, objectives, and benchmarks for the use of MCC assistance.

We are not pushing any particular sector or project, but instead we seek to help those countries find the best opportunities for poverty reduction and growth.

President Bush has requested \$2.5 billion for fiscal year 2005. In an analysis earlier this year, the General Accounting Office estimated that with a funding level of \$3.5 billion, the President's 2005 request plus the fiscal year 2004 enacted levels, the MCC can fund compacts in only 8 to 14 countries at a level that would provide a meaningful incentive for policy reform. MCC is a good investment in security, poverty reduction, and growth, and achieving an adequate level of funding is essential to our mission. I very much appreciate your support, and that of the members of this committee in achieving adequate levels of funding.

We are now looking at the country proposals that we received. We are looking at them as investment opportunities. However, the return we seek is not a financial return, but a return in poverty reduction and growth. We want to give our partners an opportunity to escape the cycle of dependency and actively change the economic path of their country and the lives of their people.

We have been impressed with the efforts of MCA-eligible countries so far and the innovative steps they have taken to ensure a broad-based consultative process. Some countries have significantly involved NGO and business sectors in priority-setting for the first time. For example, Mongolia is holding public meetings throughout the country. Armenia and Georgia have broadcast public meetings on national TV. One official from an MCA country in Africa said: "Even if we receive less than we have requested through our compact proposal, the intangibles gained from taking control of our own development destiny are the most important part of the process."

Just as important, the potential for qualification is a continuing incentive for countries to make reforms. One country passed four pieces of anti-corruption legislation and began enforcement. The stated reason: They hope to qualify for MCA funding. Since the announcement of potential MCA indicators in February 2003, the median number of days to start a business has dropped from 61 to under 50 in MCA candidate countries.

The first country proposal reached MCC in mid-August and a number of countries have submitted proposals and concept papers. What we see thus far covers almost all areas linked to poverty reduction and economic growth, education, health, water, microcredit, rural development, infrastructure and financial sector development. As we begin our due diligence, we are asking direct questions: What is the link to poverty reduction and growth? Who are the beneficiaries? How will we measure results? How will the proposal impact the environment? Will the money be well handled?

We are also coordinating with the United Nations Development Program, the World Bank, and other donors and working closely with USAID, State, and other U.S. Government departments to think through technical issues, to coordinate our activities, and to maximize the effectiveness of our assistance.

We anticipate that we will begin consulting with Congress about entering our first compact negotiations in the near future. This consultation will occur once we have conducted a thorough review of a country's proposal to determine whether there is a basis for conducting more formal negotiation. My personal hope is we could sign one or more compacts by the end of this year. But let me be clear that MCC is not in the business of rushing funds out the door before it is satisfied that the proposed compact will achieve real measurable results.

As I emphasized earlier, underlying all MCC's efforts is the importance of incentivizing policy reform. We believe this objective is enhanced by the threshold program. For fiscal year 2004 the board selected Albania, East Timor, Kenya, Sao Tome and Principe, Tanzania, Uganda, and Yemen to be invited to submit their proposals for improving their MCA indicators.

To encourage and support these reforms, we are working closely with the USAID to assist these threshold countries with targeted programs that will help improve their policies so they have a better chance of qualifying for MCA assistance. Let me emphasize, however, that selection for the threshold program does not ensure automatic or quick selection for MCA eligibility. The type of reforms that the threshold program is designed to assist requires leadership and commitment over a period of time.

Like MCC's primary programs, the responsibility lies with the countries. If these countries want to undertake the challenge and opportunity, we will support their efforts. Eligibility, with or without threshold program participation, will be judged only against clearly measurable data that reflect the concrete efforts made by the governments.

Operationally, MCC has increased its staffing and has developed detailed hiring plans, while addressing the basic issues inherent in the startup. We have sought to bring to MCC the most highly qualified individuals with diverse backgrounds and experience in government, the private sector, multilateral institutions, NGOs, and higher education.

I could continue speaking at length about the ways we are constructing the foundations of MCC, but perhaps your questions will allow us to address these subjects in more detail.

In closing, let me remind you of our ultimate beneficiaries, the people we have been created to help. Madagascar, one of our poten-

tial partners, has a population of 16.4 million, who on average earn less than 64 cents a day. These people, like the rest of the world's poorest countries, live with hopes, aspirations and potential as yet unrealized. The Millennium Challenge Account exists to help the world's poorest countries and exists because of a significant bipartisan consensus here in Congress that clearly recognizes the importance of effective and lasting global poverty reduction.

Through MCC we have the capability to carry that task forward, to help create a world of free and prospering nations. I believe that together we can do this by working closely with our partner countries, by insisting on commitment and accountability, and by focusing on poverty reduction and growth to help them move toward a more flourishing and more stable future.

I thank the committee for its support and attention this morning and I would be glad to answer any questions you have about MCC and its operations.

[The prepared statement of Mr. Applegarth follows:]

PREPARED STATEMENT OF HON. PAUL V. APPLGARTH

Thank you very much Mr. Chairman—and members of the committee—for the opportunity to appear before you this morning. Six months ago, I was testifying before you as President Bush's nominee to become the first Chief Executive Officer of the Millennium Challenge Corporation (MCC). Yet during these past six months, MCC has designed and implemented its operational structure, carefully reviewed and selected countries that are eligible to formally apply for assistance from the Millennium Challenge Account (MCA), announced the first threshold countries and—at this very moment—we are evaluating the first proposals and concept papers that have arrived from 13 of the 16 countries.

As the Committee is well aware, it was only on January 23rd of this year—with sustained bipartisan support—that MCC was established as a unique and innovative foreign assistance program. By establishing MCC, the United States Government has boldly (and generously) begun a new era in poverty reduction and sustainable development. Underlying all our efforts is a pronounced emphasis on policy reform. We believe that by providing incentives for countries to adopt policies for governing wisely, investing in their own people, and promoting economic freedom, we strengthen abroad the critical relationship between free market ideals and fundamental democratic principles that together form the “bedrock” of stable and responsible nations.

MCC is unique because it was deliberately designed to make U.S. aid more effective by linking increased foreign assistance to good governance and sound policies. We are innovative in several important respects: countries are selected based on their capacity to perform according to the stringent standards mandated by Congress; countries are also selected based on their ability to participate—as full partners—in the development process. This genuine partnership with selected countries means that they themselves will design programs—with MCC evaluation and guidance—that directly address the root causes of poverty; it means that the countries themselves will seek to stimulate economic growth in those areas that they determine are most important.

Since January 23rd, MCC has set ambitious goals for itself, and then met them, moving as fast as legislation allowed. MCC legislation has a series of sequential requirements—naming candidate countries, publishing criteria and methodology for selection, and holding a public comment period—each followed by a waiting period before selection can take place. MCC opened its doors with only 7 staff members. I am both grateful and proud to inform the Committee that MCC has met—and in some cases surpassed—every one of these requirements. On May 6, MCC Board of Directors (Board) was able to select with confidence the first 16 countries eligible to submit proposals for MCC assistance; again, all of this activity took place as quickly as the current law would allow.

These 16 countries, which when combined represent more than 130 million people, were selected out of 63 of the poorest countries in the world. The selection was based on published criteria, including how well (or poorly) the 63 countries performed on 16 indicators developed and monitored by the World Bank Institute, Freedom House, and other entities independent of the U.S. government. MCC uses these

16 independently derived indicators to evaluate the policy performance of countries in terms of whether or not they are “governing justly, investing in their people, and encouraging economic freedom.”

Let me emphasize that the performance of the candidate countries on the sixteen policy indicators are completely transparent: any member of the Committee, any government staff, and—perhaps most important—any interested member of the public can look at our Web site ([www.mcc.gov](http://www.mcc.gov)) and see how the candidate countries scored this year. In order to become candidates for fiscal year 2004, countries had to have an annual per capita income of under \$1,415 US dollars (the historic cutoff for the International Development Association), be eligible for assistance from IDA, and be eligible to receive U.S. assistance.

#### FY 2005 SELECTION PROCESS

MCC has already announced the names of the 71 candidate countries for fiscal year 2005. Because the MCA legislation no longer required that countries be eligible for IDA loans, the number of competing countries has grown. We expect our Board to select 2005 Millennium Challenge Account (MCA) eligible countries before the end of the year, probably next month.

It is also important to point out that since the FY04 selection criteria and methodology were announced, MCC has received valuable public comment. These comments were taken into account during our review of the criteria for FY05. In a direct response to public comments, MCC replaced the Primary School Completion Rates indicator (for all students) with a Girls’ Primary Completion Rates indicator. We made the change to emphasize clearly the proven importance of primary education for women in terms of poverty reduction and high economic return because data was now available to provide a measurable ranking. The second indicator change MCC made was to lower the ceiling inflation rate indicator from 20 to 15 percent in order to make the indicator a more meaningful test of a country’s economic policies.

In addition to the two changes to the selection criteria for FY05, MCC will explore potential changes for the future, such as measuring a country’s support for entrepreneurial activities, improved focus on investments in people, and the economic cost of trade barriers. Taking into account suggestions from the public and advice from Congress, MCC will also establish a working group to help identify—or promote the development of—an indicator to measure a country’s policies as they affect its natural resources. The group will be chaired by MCC Board Member (former Governor of New Jersey, and most recently head of the Environmental Protection Agency) Christine Todd Whitman. This group will work with outside groups and experts to establish criteria and invite ideas for such an indicator.

#### COUNTRY COMPACTS

Within weeks of the selection of the first round of MCC eligible countries in May, we had MCC teams on the road to visit the countries. Working together with USAID and our Embassies, we explained to a wide variety of groups in each nation that we want each country, through a consultative process with civil society and the private sector, to develop a Compact proposal—which is essentially a plan that lays out country priorities and objectives for the use of MCA assistance to address barriers to poverty reduction and growth in the country. These proposals form the basis for discussions between MCC and the country on their priorities and, finally, for negotiating a mutually agreeable Compact that includes plans for ensuring accountability, and clearly lays out the responsibilities of each partner.

As investors using U.S. taxpayer dollars, we are not pushing any particular sector or project, but instead we seek to help these countries find the best investment opportunities for poverty reduction and growth. President Bush has requested \$2.5 billion for FY05. In an analysis earlier this year, the GAO estimated that, with a funding level of \$3.5 billion—the President’s FY 2005 request plus FY 2004 enacted levels—the MCC could fully fund three-year Compacts in only 8 to 14 countries.

We will be looking at proposals we have received as investment opportunities. The return we want to see is poverty reduction and sustainable economic growth in the countries. We want to give them an opportunity to escape the cycle of dependency, and actively change the economic path of their country and part of our strategy is that this is best accomplished by allowing them to take ownership of the success of the program.

That means that the programs are about *our partner countries’ priorities, their ideas, their activities, their policy reforms and compacts should reflect the priorities and needs of the people of the country—not just the government—by placing a strong emphasis on civic and private sector participation in setting priorities and then implementing these priorities.* This is why we have met with key individuals

in each country—inside and outside of government—such as the private business sector, NGO's, and other organizations that have an important stake in the positive development of their nation.

We have advised countries that we would assess their proposals based on a number of criteria, including:

- the proposal's contribution to poverty reduction and economic growth;
- the breadth of public support within the country for the proposal; and
- the government's commitment to continued policy improvement.

We explained to them that MCA eligibility does not mean automatic entitlement to funding, and that MCC allocation and funding decisions will be driven by the quality of each country's proposal and their ability to successfully implement the Compact as well as the Congressionally mandated criteria for a robust financial management plan so that U.S. taxpayer money is optimally used.

We have been impressed with the efforts of MCA eligible countries so far and the innovative steps they have taken to ensure a broad based consultative process. Some countries have consulted NGO and business sectors for the first time. Mongolia is holding public meetings in all four corners of its large expanse. Armenia and Georgia have broadcast public meetings on national TV. One official from an MCA 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." Indeed, we are finding that the process itself is an incentive for progress.

Just as important, when countries don't achieve eligibility, the potential for qualification is a continuing incentive for them to make reforms and become eligible. One country passed four pieces of anti-corruption legislation and began enforcement. The stated reason: the hope of qualifying for MCA funding. And since the announcement of potential MCA indicators in February 2003, the median number of "days to start a business" dropped from 61 to 47 in MCA candidate countries.

Many countries decided to include additional parties in the consultation, and as a direct result of this increased participation they have achieved a much deeper analysis and more careful prioritization. They know this will lengthen the proposal development process, but they believe it will increase proposal quality and as well as its acceptance within the country.

The first country proposal reached MCC in mid-August and a number of MCA countries have now submitted proposals and concept papers. What we have seen in the proposals and concept papers thus far covers almost all areas linked to economic growth and poverty reduction: for example, education, water, micro-credit, rural development, infrastructure, and financial sector development. We have begun our due diligence processes. We are asking direct questions. What is the link to poverty reduction and growth? Who are the beneficiaries? How will you measure results? How do you rank your priorities? How will the proposal impact the environment? How does your proposal relate to what the government and other donors are doing? Will the money be well handled? Is procurement going to be fair and transparent?

As part of our due diligence process, we have already begun consultations with the United Nations, the World Bank, the UK's Department for International Development (DFID), Japan and other donors. We are doing analysis on the growth and poverty reduction potential among proposals. We are working closely with USAID, State and other USG departments to think through technical issues, to coordinate our activities, and to maximize the effectiveness of our assistance.

MCC anticipates that we will begin consulting with Congress about entering our first Compact negotiations in the near future, as prescribed in our legislation. This consultation will occur once MCC has conducted a thorough review of a country's proposal to determine whether there is a basis for conducting a more formal negotiation. We believe that due to our efforts as well as the efforts of the countries, that we will make significant progress on several proposals by the end of this year. My personal hope is that we could sign one or more Compacts by the end of the year. Let me be clear, however, MCC is not in the business of rushing funds out the door before it is satisfied that the proposed Compact will achieve real, measurable results.

#### THRESHOLD PROGRAM

As I emphasized earlier, underlying all MCC's efforts is the importance of incentivizing policy reform. In many ways, this is the challenge in the Millennium Challenge Account. But we don't just want to challenge these countries that are eligible, but also those countries that currently fall short on MCC indicators but are making efforts to reform. We believe this objective is enhanced by the Threshold Program.

The Board made the decision to set aside an initial pool of up to \$40 million dollars from fiscal year 2004 funds to go to the “Threshold” countries that are very close to qualifying and have demonstrated a commitment to undertake the policy reforms necessary to improve their growth conditions and their prospects for qualifying for the MCA. For FY 2004, the Board selected Albania, East Timor, Kenya, Sao Tome and Principe, Tanzania, Uganda, and Yemen to be invited to submit their proposals for improving their MCA indicators.

To encourage and support reform, we will be working closely with USAID to assist these “Threshold” countries with targeted programs that will help improve their policies so that they have better chance qualifying for MCA assistance. Moreover, such a program can help countries put in place the policies that provide the foundation for increasing productivity, reducing poverty, and moving toward more sustained economic growth. Distinct from the poverty reduction and economic growth programs that are MCC’s primary focus, the hope of qualification presents these countries with an opportunity to actively address and improve their performance on the policy indicators.

This type of reform requires leadership and commitment. Like MCC’s primary programs, the responsibility lies with the countries. If these countries want to undertake this challenge and opportunity—we will support their efforts. However, I want to make it clear that simply participating in this program will not guarantee eligibility for MCA assistance. Eligibility, with or without Threshold Program participation, will be judged by clearly measurable data and concrete efforts made by the governments.

Change will not be easy and will not soon be reflected in country scores. The policy areas where these countries will need to focus can only be changed with consistent effort and a high level of political commitment—over a period of time.

Building on our strong working relationship with USAID, MCC will ask countries to submit their plans for reforming failing indicators and we will evaluate their final proposals based on political commitment, looking for specific actions that the government will undertake. MCC will soon post guidance on our Web site explaining the parameters for submitting such a proposal.

MCC has also increased its staffing and has developed detailed hiring plans to ensure that MCC will have the right number of people and skill sets to analyze proposals from both eligible countries and those in the Threshold Program. In less than nine months the number of staff has gone from 7 to 63 (which includes contractors) and we have sought to bring MCC the most highly qualified individuals, with diverse backgrounds and years of experience in government, private sector development, multilateral institutions, NGO’s, and higher education. I could continue speaking for a considerable length of time about our goals for specific departments, the meticulous and frankly demanding way in which we are constructing the foundations of MCC. But perhaps your questions will allow me to address these subjects in detail.

In closing, Madagascar, one of our potential partners, has a population of 16.4 million people who, on average, earn less than 64 cents a day. These people live with hopes and aspirations for a better life that are as of yet unrealized. The Millennium Challenge Account exists to help them and others among the world’s poorest countries to achieve their potential. MCA also exists because of a significant bipartisan consensus here in Congress that clearly recognizes the importance of effective and lasting global poverty reduction.

Through MCC we have the capability to carry that task forward—to do our part in creating a world of free and prospering nations.

And I believe that, together, we can do this by working closely with partner countries, by insisting on commitment and accountability, and by focusing on growth, nudging each nation toward a more flourishing, more stable future. And that will be a great good, for us all.

I thank the Committee for its attention and support. I would be glad to answer any questions you may have about MCC operations.

The CHAIRMAN. Well, thank you very much, Mr. Applegarth.

We will have a 10-minute round to begin with for our members. When was the threshold group of countries announced?

Mr. APPLEGARTH. It was announced last Thursday, September 30, Mr. Chairman.

The CHAIRMAN. I appreciate your giving that list to us today. I mention just anecdotally the selection of Albania as one of the seven. It was my privilege to visit Albania in August. I would say



that the Prime Minister, and all of the ministers with whom I visited, were extremely hopeful of being included on the threshold list. They thought that they had taken steps, which they outlined to me, that would qualify them to do that.

I could offer no assurance, but let me just underline some of the points you have made in your testimony about the internal debate which is occurring in countries around this world. Albania is a focus because I talked to the people there and they had in mind first of all some MANPAD missiles that were up in the mountains, at least 79 of them as I recall, that they were prepared to destroy.

Now, this has nothing to do with economic assistance and the normal things that we are involved with, but it has everything to do with a country that is forthcoming, and that wanted to make sure that these missiles and various other things that were in sheds and so forth and that were revealed to us as we proceeded up above Tirana were going to be destroyed safely. The Albanian officials wanted some degree of expertise as they worked with the United States.

In addition to that, they outlined the idea of a military academy, in which young officers in the Albanian armed forces would come forward. One of the requirements of this would be proficiency in the English language—once again, a clear reaching out to us to indicate that they really wanted to be friends and to be part of the move toward democracy.

Then we heard a very vigorous debate over the dinner table in the Ambassador's residence. This included the Prime Minister, but likewise members of at least two distinct political parties that were in the opposition, who felt free in arguing publicly and vociferously about the course of affairs in the country, which I think is very healthy.

Now, you are running into that, I am certain, with your administrators as you visit these countries and as they become aware of the possibilities. I have no idea what sort of plan Albania will propose, but I think it will probably be a fairly good one. They have given some thought to this, and their hope is that they might be included.

Other countries in the world are out there in the same condition. When I visited Georgia shortly after the Albania visit, they were extremely pleased and, as you said, have had public meetings. It is a point of national interest that they are formulating a plan. I do not know whether they have submitted one as yet.

In both of these countries the needs are obvious to an observer just walking along the street, quite apart from going out in the countryside. They have extraordinary needs. But in Georgia the application that they have given was preceded by a tremendous crackdown on public corruption, including dismissal of most of the police force of the entire country and rehiring of persons on different terms, and a whole culture of change, with the young people from the Rose Revolution. It is extraordinary for that area, exemplary, in every way. This should be supported by us in our public diplomacy and in our espousal of democracy.

So this is not an incidental program that we are discussing. I have already gone through some criticism of the Congress for its lack of prescience with regard to our possibilities in the world, but

at the same time, this is why the urgency of this situation impelled this hearing before we go out of session. Members have many things on their minds. It is the final week of session and people sometimes say: Not another hearing. Yes, we are holding another hearing. We are here because we really want to hear from you, and we have some benchmark at this point.

We will return to this subject. We must. The appropriations process for the next year is upon us there rendering this matter particularly urgent.

Now, it is in that spirit that you have indicated that probably some compacts will be concluded in this calendar year, but can you quantify that any better? How are the 16 coming along? What sort of timetable may we expect before we see the results of those examinations?

Mr. APPLGARTH. I will certainly do so, Mr. Chairman. I wanted to emphasize something you mentioned, which is the impact in the countries. I think some of the most interesting and positive feedback we have received, that I have received, has been in discussions with the Presidents and Prime Ministers of countries, some of whom qualified, but a number of whom did not.

I know Secretary Powell has also mentioned this, but to see our little country data sheets, which are available on our Web page, in the hand of a President or a Prime Minister—as happened twice in New York the week before last, is gratifying. Two different Presidents said: Paul, we really want to qualify for Millennium Challenge; Why did we not?

In one case I had to say: Mr. President, because you fail our corruption indicator. And he said: I understood that and I just needed to have you confirm that; what kind of things should we be doing? And I said: We are not going to be prescriptive. It is a partnership. We just set the benchmarks. But let me tell you what some of the other countries that did qualify have been doing.

To have this opportunity to talk with the senior, truly senior leadership of countries about what is important in terms of promoting good governance, in terms of promoting economic freedom, in terms of investing in their own resources, is really extraordinary. We get constant feedback and constant reinforcement that this joint mission that we are all about is really significant.

In terms of the compact proposals themselves, as I mentioned, we got our first one in mid-August. They continue to come in virtually every other day. I think we got the most recent one on Friday. To be fair, they all require still a fair amount of work. A lot of them have had a lot of effort going into them, but they all require a focus on true prioritization and more detailed implementation and work.

I think the 13 that we have received total \$4.2 billion themselves. Now, there is no question that I am in complete sympathy with Senator Alexander's remarks, but even if I was not, we would still focus only on the very best, and the countries understand that in terms of the available funding we have. We think it is also very important that we show a clear linkage of high quality plans and proposals to poverty reduction and growth.

My own experience in the private sector has been that, even when you get a very good proposal with parties that are used to

doing funding, whether it is the private equity world or other kind of worlds, for this kind of investment it frequently takes 4 to 5 months to negotiate a contract—even in the best of circumstances, from the time you get the proposal until you get to completion.

Therefore, I say it is my personal target and I hope we can get a couple done by the end of the year. But I also have to recognize that this is a learning process for parties on all sides. Our emphasis is in the consultative process, which is certainly not typical in a private sector perspective, and the fact that we are asking governments to step up and do a number of things that they have not done before, and at the end of the day we need a government to government agreement, says that that is a stretch target, an ambitious target, but we will try to do it.

The CHAIRMAN. Well, you are between a rock and a hard place because on the one hand you are attempting to do the responsible, prudent thing, and you must. On the other, the governments that are involved, 13 of the 16, have sent them, but three have not, and here we are on October 5.

The problem in our government, however, is that already the appropriation that MCC will need for the year following this year is going to be going on during November and December. Before long, OMB and others will already be suggesting what the limits are. You understand our predicament as advocates. We understand yours, that there has to be a track record that somehow you are handling this money, you are handling it successfully and we are getting results. Failing that, the result is going to be that people will say: Well, you are not able to use the money that fast, you are just not able to assimilate this. They will say, it is a good program, but by and large we should fund it at half-speed.

This is what I am worried about, quite frankly, and that is why in my opening statement I offered the long recitation of the battles over the foreign account, the 150 account, which all of us are engaged in. This is hand-to-hand combat each year on this business.

Let me just mention one more thing. The capability corruption item is just critical. We have held hearings on the multilateral development banks. Granted, this is an area that people do not get into very often, and some would say hardly should get into at all. It is off somewhere else. There are many countries involved and we play a part in it. But who knows exactly what happens when loans are made to a government for budgetary support?

Well, somebody needs to. In other words, the accountability of American taxpayer funds, however humanitarian the intention may be, is of the essence. A corrupt government on the face of it, even if it has great needs, is not a candidate for MCC funds. We know off the bat that this is very bad news.

I had the Foreign Minister of Papua-New Guinea in the office on Friday, an able gentleman and an able Ambassador who once came over here on a Henry fellowship or what have you. Unfortunately, all the fellowships for Papua-New Guinea were cut off about 1997, which is sad. We will address international scholarships in a separate hearing tomorrow.

The corruption business, as we found in these multilateral development bank oversight hearings, is just endemic. Cases like Georgia, with the young people overthrowing their government, these

are extraordinary exceptions in the world. And yet you have a great opportunity here to fashion a different culture that will be of great benefit to people in terms of their governance, quite apart from their economics, which you understand.

Let me pass the baton on to Senator Feingold for his questions.

Senator FEINGOLD. Thank you, Mr. Chairman.

I would like to start, Mr. Applegarth, by asking you essentially the same question I asked you at your confirmation hearing in March, which is: How will the MCC monitor the very significant expenditures of taxpayer resources with a total staff of about 200 people?

I understand it is your intention to have about 20 people based overseas to monitor programs in 30 countries by fiscal year 2006. As the recent Inspector General's report noted, \$5 billion a year, as the President called for, spread over 30 countries still averages out to \$167 million per country per year. Do you think that 20 roving employees can adequately monitor the use of these taxpayer dollars?

Mr. APPLGARTH. I think we are different, Senator, because we have the true country partner "buy-in" as to what we are doing, and it is not only our resources, in that we view ourselves as fiduciaries to the American taxpayer, but at the end of the day this is also their resource. This opportunity is a rare one for them, and we are fortunate in picking really the best of the highest ranked of the potential countries we are working with.

We will, as a part of the detailed implementation plan under a compact, have explicit monitoring benchmarks and methods and procedures built in, and essentially we will monitor the monitors. We do not expect our staff to be doing the detailed monitoring, but we will be working with the partner countries to make sure that that happens correctly.

In addition, those compacts and those procedures will all be public and available. We have been trying to encourage both the community here as well as in the countries to participate, so they know what the benchmarks are, they know what the intentions for where the money is supposed to go are, and so we expect to have not 20 watchdogs, but thousands of watchdogs in each country in some way that are helping us do this informally as well as formally through the procedures we build together with the country and the compact.

Senator FEINGOLD. I appreciate that answer. Let me follow by asking if these plans for monitoring and evaluation of the Millennium Challenge are based on any existing model? Is there some existing arrangement that you can point to that will give us confidence that we will be able to keep close tabs on our taxpayers' dollars, especially since you are talking about a relatively modest staff of American employees and an interesting concept of thousands of other people helping us in those countries? And I am wondering if there is some other model that would suggest it might work.

Mr. APPLGARTH. We are looking at the best that is out there. We are different in some ways because we are combining what the private sector does in terms of ongoing and short-term monitoring and quarterly monitoring, if you like, or even more frequently, as

you would if you were sitting on the board of a country or of a company, together with some things that the World Bank has been doing and the IDB has been doing and elsewhere, in both looking at the long-term impact, but also the short-term monitoring basis.

We have been looking closely at both successes and failures in monitoring in those other institutions and we will try to pick the best of them, depending upon the sector and depending upon the country. It is just going to vary by both.

Senator FEINGOLD. What will it cost for the MCC to maintain these 20 employees who are based overseas? And are you asking the State Department or USAID to share some of the cost, and how much?

Mr. APPLGARTH. Well, we have been working closely with State and USAID to make sure we are leveraging our staff resources to the extent we can. By design we are not intended to be creating another bureaucracy. We are really modeled much more on a professional services entity, where we are subcontracting out anything that is not critical to our mission. So that we subcontract out things like our personnel administration, our internal accounting, even our security clearances, so that our folks really are directed to our mission, which is to work with the countries to make these things work.

In many countries, we expect to be housed in the embassy or with the USAID mission. It will vary on the country's circumstances, but that would be our intention. To the extent we can leverage the usage of other U.S. Government resources in the area, we would like to do that. We have been getting quite good cooperation on the ground from both our Ambassadors and the mission heads from USAID in particular.

Senator FEINGOLD. I think I understood that answer. Let me followup by asking, does the MCC anticipate asking USAID or State Department personnel to assist in the monitoring effort?

Mr. APPLGARTH. We can and I think it will be country specific. As you know, we certainly will be seeking their views and their input. Whether or not they have the resources to do that for us I think is really up to them.

Senator FEINGOLD. Would State or USAID be reimbursed for these costs?

Mr. APPLGARTH. We would attempt to, I think, work out on a country by country basis arrangements that would work for them as well as for us. We are not going to divert them from their primary missions.

Senator FEINGOLD. Some have voiced concerns that lobbyists have been retained at a significant cost to extremely poor countries to help represent developing countries that wish to participate in the Millennium Challenge initiative. Obviously, this is troubling since the whole premise behind this initiative is that objective performance will be rewarded. It is not supposed to be about who is in and out of political favor, who has a high-priced lobbyist, and who does not.

What's more, the objective indicators are well-known and publicized. Certainly our embassies should be able to explain clearly how one qualifies for MCA assistance. So it would trouble me if some countries believe that by hiring some professional lobbyist

that that is a good investment, rather than, say, implementing the actual policies that the chairman was talking about to root out corruption.

Does this phenomenon trouble you? Do you have any idea of how widespread the phenomenon is, and what steps are being taken by the MCC to discourage this kind of activity?

Mr. APPLGARTH. I share your concerns 100 percent, Senator. This is not a good use of funds. I have been quite public about that. This is not an approach that countries should take. As recently as last Thursday, I spoke before a large audience at the Bretton Woods Conference. In response to a particular question from an emerging market Ambassador, I repeated the fact that success with MCA does not involve lobbyists.

We have seen only a couple instances of it, and I cannot think of a case where a lobbyist was hired that I am aware of where the country was selected in this first round. The board takes it quite seriously that its selections are based on the criteria and not politics and lobbying. I think that is the best signal, both our jawboning and the fact that it does not work.

Senator FEINGOLD. I am very pleased to hear you have shown concern about this already, and over time I want to work with you to make sure we stay on top of this possible problem.

What steps has the MCC taken to ensure that civil society in qualifying countries is engaged in actually developing compact proposals, so that this program really empowers citizens and not just empowering governments overseas? What can you do to bring civil society into this process?

Mr. APPLGARTH. Transparency is our biggest ally, particularly now when we are trying to build confidence that we will use the money well. In the countries—in every country that we visited on the initial rounds—we had separate meetings with civil society, with NGOs, members of the business community. Most of our followup trips have involved similar meetings.

We have asked the countries to in their compact proposals, to discuss and explain their consultative process. It is clear to them that we are taking it seriously, and, as a result, they are taking it seriously, and it is constantly reinforced in our messages to other countries and in our discussions and they know it will be a key element of our due diligence.

Senator FEINGOLD. Thank you, Mr. Chairman.

Thank you, Mr. Applegarth.

The CHAIRMAN. Thank you very much, Senator Feingold.

Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you.

Mr. Applegarth, welcome. We are grateful for your leadership and please convey to your colleagues that we appreciate their good work and you are off to a very productive beginning.

As noted in your testimony and in the opening comments of Chairman Lugar, the current funding for MCA is below expected levels, below what the President had requested. Most of us on this committee fought for that mark. We did not achieve that. Now, as that as the context of the issue, I have got two or three questions regarding that shortfall in funding for fiscal year 2005.

The first is, what impact does this have on planning and implementation as you have completed fiscal year 2004? More importantly, you are planning for 2005 with essentially a billion dollars less than what the President had requested.

Mr. APPLGARTH. It affects us in a number of ways, Senator. As we evaluate proposals and really build a pipeline, it is crucial that we have adequate funding. If you come back to what we are really about, it is to provide an incentive to countries to enact policy reform. It would be a fundamental problem if countries gave us good proposals—and there are a lot of good elements in proposals in what we are receiving right now—and that as a result of the cut-backs in funding, we either had to eliminate countries that had good proposals. There will be some countries that do not have good proposals. We are confident of that. But if there is a proposal before us that has good merit, that clearly leads to poverty reduction and growth, and we are unable to fund it, we have built expectations in the countries, their governments are taking heroic steps. Georgia is a very interesting example, the things they are doing, but there is also leadership in our other partner countries where they are trying to do things. If we fail to deliver on the Monterey promise that if they take those steps we will be there to help provide assistance, we are going to get questioned: Well, where is the beef? What happened?

I think it is important to us in terms of our role in the world that what we are doing be funded adequately. I think it is important for U.S. credibility and I think it is important in terms of poverty reduction and growth, and we will come back to that. So it is very important as we go forward that we be able to work with the countries and credibly respond to good proposals as we have encouraged them to submit.

Senator HAGEL. In the same regard as the general question that I asked previously, what specific contingencies are you taking to deal with the shortfall? If you could give the committee one or two or three examples? You have laid out a general dynamic of what you are going to be dealing with, the concerns, the vulnerabilities, the down sides, but what are you doing to prepare for this?

Mr. APPLGARTH. Well, first we are being rigorous in our evaluation of the proposals. We do that anyway, but I think we have tried to make it clear to the countries that only the best proposals will qualify. We are looking at timing; we think it is very important to have full funding up front in a compact, so the government can really plan and does not at the last minute get a rush of funds that ultimately leads to inefficiency and corruption.

We are trying to make sure that the planning is up front. There are some things we can do in terms of funding technical assistance or evaluate in early stages something where we can perhaps as funding comes through amend the proposal to increase the funding once we have the certainty of it. At the same time, we will obviously do the other things we can in terms of adjusting timing. We think a number of countries will qualify in the future, if we pick the right countries, and qualify for 2006 funding, qualify for 2005 funding.

But the reality is it is important, if we are going to do this right, that we do get the funding that we need. We will obviously manage

the program to the resources that are available, but I cannot assure you that significantly reduced funding would not impact either our mission, how the U.S. is viewed, or what we are trying to do.

Senator HAGEL. So the level of funding for fiscal year 2005 could in fact affect the countries that have been selected? We just might not be able to fund those programs, after we have committed to the world that this program was effective and new and efficient and was a partnership that was very important for them?

Mr. APPLGARTH. Absolutely, Senator. I think that is a very important point. At current funding proposals it is inevitable that the number of countries that we work with will be reduced, the size of the programs will be reduced, and/or our ability to truly create the incentives for the kind of policy reform that we are really all about will be impaired.

Senator HAGEL. I might note, Mr. Chairman, this is at a time when America is reaching out to the world, trying to improve its standing in the world, trying to develop relationships, partnerships, based on common interests, and these are the kind of programs that probably are most effective, have the most long-lasting effects of any, but yet we are shortchanging these kinds of programs and I think, Mr. Chairman, very clearly undermining our overall foreign policy objectives.

Is there any way that other donors can assist to fill in some of these gaps, Mr. Applegarth, that we are going to obviously come up underfunded and we are going to need some assistance to fill those gaps?

Mr. APPLGARTH. We are looking. We are working closely with other donors, first to make sure that they stay in the countries that we are coming into. We will start the conversation within the context that we do not want them pulling back simply because MCC is coming in. We lose all of our additionality, all of our incentive effect if they are not there.

We are trying to align what we are doing with their programs, to the extent it is consistent with what the countries have identified as our priorities. It is not just with other donors, but I will mention one specifically. I just came back from Central America, where the countries propose that we do something that ties in very closely with something the World Bank and the IDB are doing, but which will take years before they can address it. We have the support of those two institutions to try to get this particular piece done.

We are also working closely with other U.S. Government institutions. The senior management of OPIC, for example, is coming over this afternoon after this hearing to talk with us about what they are doing to put in place, how we might be able to leverage their resources and their capabilities to supplement what we are doing and provide more bang for our developing buck.

Now that you have got me started; the private sector. I had a conversation on Friday with an institution that is looking closely at moving back into one of the regions we have been operating in. They have not been there for a while. They are trying to decide the best way to do it and to pick the areas of opportunity for them. Coming out of that conversation I think was a recognition that the criteria that we are using to evaluate countries that really do rec-



ognize good governance and recognize long-term growth and poverty reduction are probably very fertile areas for them to be putting their money. It is clear from that conversation they are going to be looking closely at the countries we pick and potentially using that as a basis for their own strategic investments.

If we can truly mobilize that kind of support, we have really delivered on the promise that we are about.

Senator HAGEL. What is the role of multilateral lending institutions, private institutions, here? How can we—and obviously you have touched on it and I want you to go a little bit further—integrate those institutions and those private lenders into this fabric to make it more complete? Obviously you have thought about that and your own background lends itself to understanding that probably better than most.

Mr. APPEGARTH. First, we have encouraged the private sector companies, both domestic and those that are operating internationally, that already have a presence in the country to participate actively in the consultative process, because we think that if there is anyone who truly knows about job creation, how to use resources to promote growth, it is the local private sector.

We are not talking about the elites. We are talking about farmers or small businessmen or housewives who start a business. We ask them to do it. We are also talking about the multinationals trying to participate through their local professional staff.

Second, we think there will be opportunities through our operations for them to participate business-wise. But more important, I think we are looking proactively for ways that their funding can complement whatever we are doing, particularly if it is not the governments themselves that are doing the implementation of some of our programs, if it is the private sector or even NGOs, others that are actually doing the program management and implementation. There would be a number of opportunities.

Senator HAGEL. Thank you. I might note, Mr. Applegarth, that the power of Chairman Lugar is immense. He was just in Albania and miraculously it shows up on your list of threshold countries 30 days after his appearance. If there is any question and doubt about the strength and power of this chairman, it should be dispelled immediately. I have understood that long ago.

Mr. APPEGARTH. I did not realize he had been there, but I am glad to know—it is in the record I did not know he was there.

Senator HAGEL. A celestial kind of happening, really.

Thank you.

The CHAIRMAN. Well, thank you very much, Senator Hagel, for underlining the authority of the chairman.

Senator Alexander.

Senator ALEXANDER. Thank you, Mr. Chairman.

Thanks, Mr. Applegarth, for being here. This is a fascinating process we all hope succeeds. As I was thinking and listening to you, there is really nothing so new about it. I can think of many examples in our society, like foundation grants. I remember when I was Governor 20 years ago, Memphis went through a big jobs conference in which they got 2,000 people involved and came up with private money, county money, city money, had a great vision for the future, and then came and wanted the State to put some

money in, and we did. Chattanooga then wanted its money, and what I remember doing is sending them back to get more people involved and to think bigger.

I can remember the New American Schools Development Corporation under the first President Bush, where David Kerns and I raised \$50 million private dollars to give to break-the-mold schools and 700 applied and 14 were chosen. I think of the private entrepreneurial sector we have in our country, where startups occur all the time and they are always looking at the people who have a lot of money to try to do things the way that people with a lot of money want them to do it.

I was trying to think of any lesson from that and the two that I thought of were these: It seems to me that you have got double objectives here. One is to introduce a way of thinking to people in a way that is attractive to them. You are clearly doing that with your indicator ratings, so you have got people thinking differently.

But to succeed it seems you need to have 5 years from now and 10 years from now a success story. It may only be one success story. It might only be two success stories. But it seems to me that that would need to be a success. Of all the new companies that start in America, most of them fail. Of all those 700 schools that applied to New American Schools Development Corporation, only 14 were chosen and some of them did not do very well.

So I would like to ask you to look down the road in two ways. One would be, how will you work to make sure that, given the uncertain amount of money and the large number of countries, that you end up 5 or 10 years from now with one or two or three real success stories?

Second, what will you do with everybody who does not make it? Is there some help—is there some way you can say to someone who comes close but does not make it that, congratulations, you have really gotten to an important point now, and here is a plateau that you have reached or an area you have reached, and here are a number of things that we can do. We are not able to give you the grant that you sought, but we can assist with all of these other things, give you a stamp of approval, and cause that country to feel good about having participated, rather than to have the government that got everybody excited be embarrassed and get thrown out of office in the subsequent election.

Mr. APPLEGARTH. It is a wide-ranging question, Senator. One thing I would say, we are not having to encourage our partner countries to think bigger. I think we are trying to encourage them to focus at this point. But I think we really cannot wait 5 years or 10 years to show demonstrable success.

We are seeing successes on the policy side and I cited a couple of them. What is most important is where we really do have meaningful impacts on poverty reduction in the areas we are working in, and growth. Inherent in what we are trying to do in our basic compact proposals with the government is to build in intermediate term benchmarks and objectives, where we can see tangible linkages in terms of outcomes and results to this investment that we are making.

So if we have to wait 5 years before we do that, I think we are not being ambitious enough. I think we really do need to tie it to the projects.

In terms of countries that are close on the eligibility side, we have that platform. It is the threshold program, where we do agree to work with them to take their proposals. If they are willing to tackle corruption in their country and give us a proposal that looks like we can provide some help, we will. The same thing in terms of rule of law. If they need training of judges or other kind of things, we will try to do that to help them.

In countries where we have successful compacts and ongoing programs, if they get off track, as long as the country commitment is there, we will do midcourse corrections. I think that is inherent in the kind of operational involvement and monitoring that we are trying to do. At the end of the day, though, I would like to see some tangible results besides the policy reforms we encourage.

Senator ALEXANDER. In terms of those that do not quite make it, do you have a name for them? What do you call them? I mean, what do you say in your letter when you say no?

Here is why—I am not trying to be tricky with you. I am thinking of No Child Left Behind. You know, many schools were very good schools, but they had a few kids who did not learn, so they did not make the grade. So they were suddenly called, quote, “failing schools.” That really made everybody feel very bad in that school. That was not really a good name.

I was thinking of an award or a designation for countries that apply, go through a process, get to a point, but do not get all the way. I think it is—maybe you have thought that through and you have that in mind or maybe you are not to that point yet. But I would think about that, because to elected officials back in various countries it could make a big difference whether they have something to brag about for having made this effort.

And funding huge amounts of money, the 13 countries plus 7 threshold countries, that will be hard to do. So you are going to have some who went a long way in the direction that you hoped they would go, but do not succeed. So I am thinking of different levels of success, that is all I am encouraging.

Mr. APPLGARTH. Well, I think you have put your finger on first the importance of the funding, that we get just as many good proposals as we can. Right now we are focused on getting good proposals, not on those who submit a proposal that does not work. We did rebrand, what I think you called them “near-miss countries,” to be the “threshold countries,” because we felt that was a more looking-forward process or offered more opportunity.

In terms of countries that submit proposals that are well thought through and that we could not fund, I would rather not contemplate that possibility, frankly. The others we will deal with in the course of the conversations with the governments. By being selected and recognized, they already have achieved something in their neighborhoods and I think in the world, but we would like to have it backed up with a good program.

Senator ALEXANDER. Yes, but if you are going to fund well a few good projects, you are going to have a number of other projects that are not funded, that may be OK but not the best. Otherwise you

would be dribbling out a fairly insignificant amount of money among a lot of—we have got 63 potential countries, more than 13 plus 7. I guess I have made my point.

Mr. APPLGARTH. I think you have. We are really asking the countries to focus first on the kinds of things that really are country-transforming, to use our MCC resources for those things, rather than things that others, particularly other donors, could do.

I also believe—I do not have any evidence, I do not have any proof of it, but I have to believe—that if a country has gone through this process well and had a good consultative process and prepared good proposals, that somehow or other we will have other donors at least coming in to help on some of it. Still it is not a perfect solution in the absence of our full funding, but it is a step. That is what we will try to do.

Senator ALEXANDER. Maybe there can be a very specific process for those, like an all-American first team and an all-American second team and both are honored in their home towns, one more than the other. But maybe you can have a specific process for the all-American second team or all-whatever it is second team, that takes them to other donors and other places.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Alexander.

Let me just follow up on some of the points my colleagues have asked. You talked about good proposals. How do countries go about attempting to either guess or estimate what we will see as a good proposal, and how inclusive are these proposals? Do countries ask for help, in say, education, sort of back-to-back with infrastructure, or banking reform, or what have you?

In other words, there is probably a long list of reforms that could occur in many of the candidate countries. How do they surmise what the tide will bear? They could present to you a \$5 billion proposal out of a single country for the \$1 or \$2 billion that you have to distribute. Is there any sense of restraint on the part of the countries? Do you counsel them as to what your fair share might be, and therefore how you ought to tailor this proposal so that it somehow meets probability?

Mr. APPLGARTH. First, the nature of the proposals, then I will come back to the second part of your question, Mr. Chairman. We are seeing, as I mentioned in my opening remarks, a variety of proposals. I think, generalizing that we have seen a number of sort of integrated rural development proposals, where countries have been very thoughtful in targeting a particular area or region after a consultative process, where they are not looking at a single intervention or support, but combining agricultural extension, training farmers in good crop rotation techniques, plus diversifying crops, to be more responsive to what the competitive market would be asking for.

The CHAIRMAN. Rural development is often an area countries look at.

Mr. APPLGARTH. Right, that, put together with drip irrigation, combined with building rural roads so they can get the products out to the market, and frequently combined with a major road leading to a port or somewhere else where they can essentially have products that meet world standards.

The CHAIRMAN. So this is a business plan of how that country's GNP might increase, both from production, distribution, movement, ports, trade, what have you?

Mr. APPLGARTH. Right, and we are seeing a lot of that. We are also seeing a number of water management proposals or elements of proposals in a very broad base. Some of the countries are quite rainfall-deprived, and if one can really bring methods of water catchment and storage and avoiding loss of use that could really impact the rural poor and others quite a lot. So that is one element of the kinds of things we are seeing and that we are having to evaluate.

We are in evaluating the proposals focused right now on really picking the best and the countries understand that. They realize they got through the first stage of this competition, but essentially they got to the Sweet 16. To get to the Final 4 or 8, there are still some more hurdles to go through, and they understand that we really will be picking and can only pick the very best of the proposals. That is what we are really encouraging them to do, to focus on those.

That is what we are trying to do, work with them to really understand which are the best in terms of poverty reduction and growth and which are ready to go, so that we begin to have an impact and right away. If something is a good idea but it is going to take 2 to 3 years of detailed planning, let us put that aside for the moment on the grounds of trying to get something done now so that they can feel tangible success and we can begin to have an impact in the country.

The CHAIRMAN. Even after you get, as you say, to the quarter-finals, or the semi-finals, and what have you, is it probable that you may pick up from some other countries that are not in the Final 4 or 8 elements that you can fund, that are part of a more general plan, but at the same time that are perhaps an integral stepping stone or foundation for what might occur later on if they are more successful?

Mr. APPLGARTH. Yes, I would hope so, either on a stand-alone basis or in coordination with other donors or other parts of the U.S. Government.

The CHAIRMAN. I was intrigued by your response on the private investment side, because some proponents of the Millennium Challenge Corporation would say that, in fact, the Federal Government may invest this money that you have talked about, but the real future for the countries that are involved comes in private investment. This is how the world discovers these countries, but even more importantly—it has probably discovered them already, it has discovered that they have a lot of problems, including corruption and difficulty with their basic institutions, whether they be legal or banking or so forth.

Through your application process, through the rigors of their looking at the 16 criteria, through how the world is looking at them as they make these internal reforms and adjustments, it is very conceivable that the path toward private investment, whether it be the United States or European or Japanese or what have you, may not be totally cleared away, but might become much happier.

Again and again, as we dealt with the breakup of the Soviet Union, Ambassador Strauss went over there. He talked to the Russians about the fact that you have to have rule of law; there has to be contract law, and courts that adjudicate disputes fairly among all the parties, and minority stockholders, as well as a number of other things that American investors are going to look for, European investors that are closer by. Some people may make investments anyway, with all the risks, expecting confiscation and so forth.

I remember one gentleman in Russia, an American investor, who invested in over 100 different enterprises. I said: Well, why have you scattered these investments? He said: Well, because of the law of averages; I expect that tens of these are going to be confiscated, or that I will simply lose some authority. But if you have 100 some may survive.

Now, most investors are not prepared to do this. Their boards of directors are not in that business. That is speculation. But to the extent that, through the process that you are bringing about here, countries do the right thing for themselves, then the path is really cleared for a lot of things to occur.

I have no idea what you do presently in terms of your public relations, within your house organs, the things that you broadcast to the world, even the things that you send over to this committee. But some of these stories, both anecdotal and actual, need to be told. In other words, right along with your judgments about who gets the money and whether they use it well, maybe even more fundamental in terms of American history or relations with these countries will be these internal adjustments that are occurring, some of them induced by you or by our State Department or by our businesses. Some reporting of what is occurring would be advisable.

Most of us on this committee—and we follow other countries more than many of our colleagues do—are usually unaware, until there is a report in the Washington Post or The Times of something that has happened, and then we clip it out and say: Well, this is good news.

But it occurs to me that your group that is examining these issues daily is much more prescient and knowledgeable about those developments and could make them known in ways that would be very important for MCC and its talented people, as well as for the other countries themselves. You could communicate that somebody is paying attention, that this is actually being said outside of the walls of the conversations you are having.

All that has certainly already occurred to you and your staff. What sort of action have you been able to take on those ideas. What do you intend to do?

Mr. APPLEGARTH. We do a number of things, Mr. Chairman. First, public outreach here and in our eligible countries is very important to us. We had, I think it was our fourth, public meeting 2 weeks ago. Each of these meetings I think has been standing room only. More important, we are globally webcasting them, so you can—

The CHAIRMAN. When was the last meeting that you held?

Mr. APPLGARTH. The last one was I think Friday the week before last.

The CHAIRMAN. Where?

Mr. APPLGARTH. The last two we have had at the General Services Administration auditorium here in Washington. I know there are several people in the hearing room today, that I saw at the meeting. We encourage that. We have—we use the Web, not only for webcasting, but we also use it as our primary means of communication, so that everything we do from reports to country evaluations to the indicators to the methodology is all on the Web.

The CHAIRMAN. On your Web site?

Mr. APPLGARTH. On the Web site. That is visible. People can see it. We solicit comments. The Web site is [www.mcc.gov](http://www.mcc.gov).

We have an e-mail list to which people can subscribe. They get notices of the meetings. We put all of our compact guidelines on there. We have had Q's and A's as questions have come in from members of the public and countries. We try to provide guidance. We have used the Web to solicit comments on our criteria for methodology and selection. So we see that as a key part of what we are doing.

In our eligible countries, in certainly every trip I take, I have asked that we build into the travel schedule an opportunity to both meet with, not just government officials or people in the capital, but to have some event that is truly out, touching or involved with people in the countryside or elsewhere, so that other people can identify within the country.

In addition, we always try to arrange some sort of an interview or media event with the largest local language newspaper. We are not talking about the international press, but the papers or the media that are viewed by local people, both to talk about what we are doing and encourage consultation and also because we see it as a strong public diplomatic impact in terms of the United States.

The CHAIRMAN. Great. Well, I appreciate that. I thank you for giving the call sign, [www.mcc.gov](http://www.mcc.gov). I suspect viewers or listeners of our hearing will be interested in that and may in fact visit the Web site.

But I would just say, do not be sparing in giving only the good news. Give a careful analysis of what you are finding, because the rigor of your criteria does make a difference to the potential recipients, as well as to those that are now forming proposals, as you imagine.

Let me just ask, is there a good relationship with USAID? How is your relationship going with those folks?

Mr. APPLGARTH. I think it has exceeded not only our expectations, Mr. Chairman, but also our hopes. We have a very strong working relationship with the USAID. As you know, Administrator Natsios is a board member. He personally, but also the members of his senior management team, are actively involved in what we are doing. They provided us briefings from their country teams here before we ever visited the countries in May. We are working with them and they will be administering the threshold program for us.

In addition, the people, mission leaders and mission teams in countries, have been very helpful to us in countries in both pro-

viding insights into what is actually going on in the country and as a source of knowledge and experience. It has been quite constructive and I think one of our success stories, if you like.

The CHAIRMAN. Well, that is really good to hear. As you remember, the initial hearings on the whole concept did not dwell on this subject, but it was an important issue: How does USAID fit into this? We explored whether the Director should be on the MCC board, and how he comes together with you in your responsibilities. So I am pleased that you have worked out a good relationship personally and institutionally with them. That is certainly reassuring.

To what extent do you depend upon USAID personnel in the countries? As Senator Feingold's questions raised, you have a relatively small staff, in terms of people who are actually out in the field. Presumably you rely upon USAID and maybe other people from the embassies. Can you describe a little bit the monitoring as you use other United States personnel there?

Mr. APPLGARTH. I think one of the merits of trying to build an organization with a small staff is that it really does encourage you to be focused and disciplined to really take advantage of the other resources out there. If you have unlimited staffing and resources, you have a tendency to build your own bureaucracy, your own little empire, and that is clearly not my motivation or the way that I think MCC works. So both by predilection and I think by design, we must work with not only USAID but others, and we really try to do it.

So far the USAID teams, in-country teams, have been helpful to us in providing introductions to key opinion leaders in the country outside of governments, showing us examples of success, where their programs have particularly been helpful in some of the areas that the governments are likely to include in their proposals, whether it is agricultural extension or policy reform, governance, rule of law. You can go country by country and talk about specifics of how that has worked—true on-the-ground cooperation, people working together.

I think as we go forward doing due diligence we will obviously take full advantage of USAID's knowledge of the countries, of what is going on, solicit their views and opinions as we evaluate compacts, and then use them in terms of our lessons learned in terms of how we monitor and prepare the monitoring and evaluation pieces, particularly their experience in country, what particularly needs to be, both what works well in that country and what we need to be watching out for.

So our door is open in terms of consultation. More than that, we are proactively seeking that help.

The CHAIRMAN. You have completed 8 months by and large of life of the MCC. How much of the \$994 million that was appropriated for the fiscal year did you spend? What is your general accounting at this point?

Mr. APPLGARTH. Our expenses, our spending so far, has been for our startup expenses and administration I think we have obligated as of the end of the year about \$6 million, of which \$3 or \$4 million has been disbursed. For programs, we have not disbursed anything. We are just getting the compact proposals in and evaluating them.



But you will see significant expenditures under those programs over the coming fiscal year as we go forward.

The CHAIRMAN. Starting the 1st of October?

Mr. APPLGARTH. Yes, as we sign our initial compacts and begin to have funding flow into those compacts. That funding, as you know, is what we call no-year funding. So that funding will be disbursed over the life of the compact.

The CHAIRMAN. Finally, you had the criteria. I remember this was a part of the discussion during the authorization of the agency. Has there been any argument or subsequent amendment of the criteria? Have you found that some are more useful than others? Probably so, but have you found some that ought to be added or subtracted? What sort of reaction have you received as you have asked them to measure up to these criteria?

Mr. APPLGARTH. We have made changes. As you know, we have pretty high standards for adopting an indicator. We really want it to be prepared by a third party, a credible third party, so that it is clear that it is not subject to politics or U.S. Government intervention. We want it to be done at an arm's length basis. We want it to be rigorous analytically in the way it is put together. We want it to be transparent in terms of the methodology, so that we and the members of the public can comment and suggest improvement.

We also want it to be linked to policies, and it is something that governments know, since we are really talking about policy reform, encouraging countries to make good policies. We want to be measuring things that they can act on and have an impact on in an intermediate timeframe.

Last, we want them to have broad country coverage. You can find a perfect indicator; but if it covers only three or four of our candidate countries, it really is not very helpful to us.

Against that backdrop, we made two small amendments to the criteria for this year, between 2004 and 2005. All of our criteria need improvement. We are seeing that improvement now that folks are paying attention I think the fact that we have gotten the attention and there is a lot of comment going on, means we are seeing those who prepare the indicators improve those individual indicators and we are evaluating—we are seeing those improvements, as well as considering others.

The CHAIRMAN. What were the amendments that you made?

Mr. APPLGARTH. The two we made this year, one was, as I mentioned in my opening statement, to change a measure of primary school completion rates or graduate rates in the country, to focus more particularly on girls primary school completion rates. It has been demonstrated through research over the last several years and since at least the late 1990s that there is a clear linkage between girls primary education rates and poverty reduction and growth. It was only recently that the data has reached a sufficient standard that we felt we could use it as an indicator, but we did adopt it for this year.

We made one other change, which we had as a measure of economic freedom; the measure of inflation rates, for which the cap was at 20 percent. We have lowered it to 15 percent as a better measure of economic performance. We will look at whether we will lower it further. The academic research is actually mixed as to

whether it would be really productive to reduce it below that, but that is one of the things we are evaluating.

The CHAIRMAN. That is an interesting point. Probably there is some economic debate. Anecdotally, I remember visiting in Turkey years ago. The ministers there were pointing out that we have at one and the same time perhaps the largest growth rate and the largest rate of inflation. This is extraordinary and probably beyond the bounds of the criteria that you have just mentioned, certainly as regards the inflation side and also the growth actually in a couple of years, too.

So obviously you have to temper this with your own experience. Turkey was not proposing itself in those days for this economic assistance. But it is simply an interesting fact in the governance of countries.

Mr. APPLGARTH. Well, it is an important fact for us, Mr. Chairman. You put your finger on the dilemma. We do not want to simply build into the indicators nice ideas. OK, we really want to have them be credible; we think there has to be a linkage to poverty reduction and growth. If we are going to encourage countries to adopt particular policies or move in a certain area, we want as strong a case as possible that those indicators and those policies lead to poverty reduction and growth, because that is what we are about.

The CHAIRMAN. Our public diplomacy section of the committee would ask, at the end of the day, after all this is said and done, are there more persons in any of these countries who would answer a question of approval or disapproval of the United States any differently? Granted, when polling many people in foreign countries, often the answer depends upon the question. If they were asked, do you like the foreign policy of the United States, do you like its military policy, do you like its President, or what have you, or do you like sort of generally the American people as a whole, usually the American people turn out fairly well, but the rest do not do so well in most countries.

Now, the problem, obviously, will not go away, and we are not attempting to buy favor. But I am curious about to what extent this whole process of the interesting criteria, the idea of increasing governance, possibly some private investment in addition to actual funds, makes any difference. Is there some anecdotal evidence that in the countries in which we are now most active, there has been more support for our general ideals? These ideals are what we are trying to promulgate here, namely, an end to corruption, or openness for girls going to school, or a lot of other things that you are suggesting.

Is this having an impact?

Mr. APPLGARTH. I think it has. As I mentioned in my opening remarks, at least one government has specifically tied some anti-corruption legislation to the prospects for MCC qualification. Another country which did not qualify—it became an election issue by the opposition to the fact that they did not qualify—and why they did not qualify became a subject of debate.

If you read the headlines, you would think the U.S. is being vilified around the world. I do not think that extends to the American people, but as a nation. I can just tell you, in the countries where we are operating, there is genuine enthusiasm, not only at

the leadership level, but at the people level, about what the United States is doing and what this means and the kind of excitement it has created, because of the combination of ideas and innovations we represent and the concept of country ownership.

The CHAIRMAN. I appreciate your personal testimony and likewise the work of your colleagues in the MCC, because this is good news. It needs to be shared. We hope that we can schedule regular hearings so that there will be opportunities to followup on what happens to the proposals that we are discussing today, as well as further developments in those countries that have advanced, in which you make awards, in which people actually are doing things. It is a story that needs, I think, constant amplification.

So this committee is, if not quite a cheerleader for you, nonetheless pretty close to that. This is a very important mission, we believe. We thank you very much for your preparation for this hearing today, and for your testimony.

Mr. APPLGARTH. Well, thank you, Mr. Chairman. As I said, both you and your colleagues here on both sides of the aisle have been very important to our being able to do what we are able to do. We already have some anecdotes of success, but the more opportunities we have to tell about them and the more stories that we have, we will certainly make an effort to get them out there, because this is a good news story. We are having real impact and trying to get at it in a way that people understand and appreciate that it is an important part of what we are trying to do.

So thank you for the opportunity today and I look forward to meeting with you again.

The CHAIRMAN. Thank you very much.

[Whereupon, at 11:35 a.m., the committee adjourned, to reconvene subject to the call of the Chair.]

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## RESPONSES TO ADDITIONAL QUESTIONS SUBMITTED FOR THE RECORD

### RESPONSES OF HON. PAUL V. APPLGARTH TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR RICHARD G. LUGAR

*Question 1.* Given our experience with the Iraq Stabilization and Reconstruction fund, the Committee is interested in your disbursement scheme. Firstly, how do you plan to disburse MCA funds? Will it be through national governments or will some funding go directly to program implementers? Secondly, will you create trust funds into which the Corporation will deposit money? And lastly, will you distribute resources only upon satisfactory implementation of earlier stages of the project?

Answer. Fiscal accountability is a key element of Compact development, implementation and oversight. Thus, MCC is devoting particular attention to the mechanisms and processes that will need to be in place to assure that funds are managed and accounted for properly and procurements are undertaken in a fair, open, and transparent manner.

As in many elements of the MCC approach, the lessons of development assistance over the last few decades have shaped the MCC fiscal accountability strategy. MCC is developing an approach pursuant to which it is expected that in many cases, governments will designate and reach agreement with MCC on a *financial accountability mechanism* that will be responsible, on behalf of the country government, for the financial management of MCC funds granted pursuant to a Compact.

In guidance to eligible countries posted on the MCC Web site, the concept of a financial accountability mechanism is explained and it is noted that different approaches could be used in its establishment. Possible examples include:

- a government ministry using existing government financial systems,
- the establishment of separate financial management units and accounts within government,

- an existing government financial system or new government financial management unit, augmented by an outside financial or auditing institution,
- the use of a private accounting firm or financial institution, or
- the establishment of a trust managed by an independent party to oversee and account for MCC program funds.

In reaching agreement with the country government on an appropriate financial accountability mechanism for the MCC-funded program in a country, MCC will be guided by the following principles:

- The mechanism should result in maximum *transparency* of financial transactions and activity.
- The mechanism should have clear lines of authority and responsibility to assure *accountability*. Performance standards should be clear.
- The mechanism should produce maximum *integrity* of financial information and assure the funds are used for the purpose intended.
- The MCC will seek, wherever possible, to *build upon existing systems*, mechanisms, and previous assessment work whenever possible.
- The mechanism should, wherever possible, *build capacity* that will remain in place at the end of a program.

While we anticipate that a signed Compact will typically obligate funds for the country's program over the lifetime of the agreement, cash disbursements will be made periodically (for instance, quarterly) by MCC into the separate account, taking into account the performance of the program to date. The financial accountability mechanism will certify cash requirements and financial reports underlying disbursement requests, prior to review and approval by MCC.

Annual audits of the use of MCC funds granted under Compact by auditors approved by MCC's Inspector General will be required. In addition, concurrent audits may be used when deemed necessary. Also, MCC staff or outside experts will periodically review the financial accountability mechanisms in-country to assure that they are operating as agreed.

*Question 2.* Could you please describe your efforts to recruit and hire an MCC staff that is a diverse representation of America with respect to gender, race and ethnicity?

Answer. MCC's short-term goal is to staff up as quickly as possible with the highest caliber personnel, in order to meet the organization's ambitious goals of both establishing its operations and delivering assistance as soon as possible to eligible countries. To do this, MCC has advertised in The Washington Post, The Economist, and The Legal Times, as well as on MCC's own Web site. In addition, MCC recently entered into a contract with Korn/Ferry International, a recruitment firm that specializes in hiring executives and managers for associations, government, not-for-profit and economic development organizations nationwide. Korn/Ferry International will be assisting MCC's Human Resources staff in the recruitment and interviewing candidates for various positions. Korn/Ferry received the *American Council on Education (ACE)—Network Leadership Award of 2001* for promoting the advancement of women in senior level positions within higher education.

Over the medium- and long-term, as MCC continues recruit staff that meet the needs of its mission, MCC expects to build a workforce that is a diverse representation of America.

*Question 3.* Will you please discuss your vision for the threshold program? How did you arrive at the decision to allocate \$40 million of FY04 appropriations for threshold country assistance?

Answer. The Threshold Program is a very important part of MCC's Mission. By targeting funds exclusively at policy reform, it is focused on MCC's fundamental objectives. IT is directed toward a limited number of countries that have not yet qualified for Millennium Challenge Account (MCA) assistance but have demonstrated a significant commitment to meeting the eligibility criteria. The Threshold Program is designed as an added incentive to countries committed to reform, and will be used to assist such countries in moving toward future MCA eligibility. Participation in the Threshold Program does not guarantee that a country will become eligible for MCA assistance in the future. Likewise, countries may become eligible for future MCA funding without participating in the Threshold Program.

The U.S. Agency for International Development (USAID), in partnership with MCC, will take the lead in implementing the Threshold Program. Other U.S. agencies and departments may play an implementation role as well.

Countries that have been selected by the Board as eligible for FY04 Threshold Program assistance have been invited to submit proposals for policy and other re-

forms necessary to improve performance on the indicators. MCC and USAID, along with other U.S. agencies where appropriate, will then evaluate proposals and determine which of these proposals merit MCC funding. The evaluation process will be rigorous and there is no guarantee that a Threshold Program for any particular country will be approved and funded.

The decision to begin the program with funding of up to \$40 million was undertaken by the Board when program parameters were being developed, to enable MCC and USAID to continue their planning efforts. MCC retains the option of returning to the Board for additional funding (up to a total of 10 percent of the amount appropriated, as permitted in the legislation) should the threshold proposals dictate that increased funding levels are warranted.

*Question 4.* Previously, MCC officials have indicated that the amount of assistance awarded will vary among countries, but will be of sufficient size to make the MCC grant either the largest or second largest aid program on average. Is this still the mission of the Corporation?

Answer. MCC's goal is reduce poverty and spur sustainable economic growth. MCC's allocation and funding decisions will be driven by the quality of each country's proposal rather than by the number of eligible countries that submit proposals. Being among the largest providers of assistance in a country will allow MCC to be an effective incentive, to command the attention needed for breakthrough country proposals, and to galvanize the political will essential to success. For that reason, it has been suggested that MCC would have to be one of the two or three largest donors in any given country.

That is why the administration requested \$2.5 billion for the MCC in FY 2005. As a recent GAO study concluded, with the full \$2.5 billion in FY 2005, together with the \$1 billion appropriated in FY04, MCC would have resources to fund meaningful compacts with only 8-14 countries in its first two fiscal years of operation. Appropriations below this amount requested by the administration, will either require reductions in the MCA programs (making the MCC a relatively minor player in some countries) or force the MCC to withhold funding from good proposals from MCA countries. Such reductions would undercut the MCA's incentive and effectiveness in achieving its goal of having a significant impact on poverty reduction and economic growth.

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RESPONSES OF HON. PAUL V. APPLGARTH TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR JOSEPH R. BIDEN, JR.

*Question 1.* How does the Millennium Challenge Corporation (MCC) measure or assess civil society's level of involvement in developing country proposals? How will you determine whether or not the non-governmental organizations that are involved are truly broadly representative of civil society, or whether there were others who should have been consulted and were not? How does the MCC evaluate whether or not women's civil society organizations have been adequately involved in the development of proposals? What steps will the MCC take if it determines that countries did not adequately involve civil society in the development of proposals?

Answer. MCC has made clear to governments, as well as its citizens, that the quality of the process used to set development priorities for MCA assistance will be an important factor in our evaluation of their program proposals. To reinforce that message, MCC has posted its guidance for developing a program proposal on the web in local languages of the eligible countries, making the guidance available to potential participants in the consultative process. MCC staff has visited all of the eligible countries—some several times—and has met with a broad range of society including the private sector, NGOs, representatives of civil society, parliamentarians, opposition parties and others to determine whether they had a meaningful opportunity to participate in the process.

If a consultative process has been open, meaningful and transparent, it will include a broad range of society, including women and women's organizations. We have asked countries to provide information about the process used and groups and institutions involved in their program proposals.

As we continue to evaluate the process through our due diligence reviews, we will seek to find out such things as to what extent were citizens able to participate in the process, and if not, what were the constraints they faced; how were their views sought; to what extent were views taken into account; whether they were provided adequate notice of the timing and location of meetings; whether they fully informed about how to contribute to the process; whether they provided an adequate oppor-

tunity to provide input; whether a broad range of societies views were represented in the process; whether certain groups were disadvantaged.

As part of its due diligence process, MCC will also consult with others in country that will likely have views on the quality of the process such as the Embassy and USAID mission and other bilateral and multilateral donors. If it is determined that the process was not open and inclusive and does not reflect the priorities of the country, MCC may reject a program proposal until an appropriate process can be undertaken.

*Question 2.* Section 609(b)(D) of the Millennium Challenge Account (MCA) authorization requires that all Compacts identify the intended beneficiaries. This was done to encourage eligible countries to think about how their work will involve and impact different parts of the population, including women and girls. How has the MCC prepared itself to evaluate whether countries have undertaken this analysis and if proposals reflect such analysis? How will the MCC respond if the impact of a project on beneficiaries—specifically women and girls—is not evident in proposals? Will the MCC be asking countries to design projects such that they take into account the specific needs of women and girls?

Answer. MCC has communicated clearly to the eligible countries the requirement that all proposals identify the intended beneficiaries and has encouraged countries to include elements in their programs that impact women and girls. MCC will conduct a comprehensive due diligence review of each proposal submitted by a MCC eligible country. An important component of such review will be an analysis of the impact the proposed MCC program would have on the intended beneficiaries, including women and girls.

*Question 3.* What happens with countries which are determined to be eligible to submit a proposal, but do not conclude a Compact with the MCC in the same fiscal year? Do they have to compete again for eligibility or can they conclude a Compact in the subsequent year?

Answer. A MCC eligible country is not required to conclude a Compact within the same fiscal year in which it became eligible. Since MCC has “no year” funding, funds that are not obligated by MCC in FY 04 can carry over to subsequent fiscal years. As a result, a FY 04 eligible country would be permitted to enter into a Compact in a subsequent year, so long as there is remaining FY 04 funding that has not yet been obligated under Compacts concluded earlier with other FY 04 eligible countries. If the country is selected in the subsequent fiscal year then it is also eligible to compete for that fiscal year’s funding, though it can have only once Compact in place at a time.

*Question 4.* Unlike other assistance programs, the MCA is designed to let countries determine their own priorities. However, there are certain priorities that the U.S. government has, such as reaching the poorest communities, minorities or other under-represented groups, that are not always the priorities of governments. How, specifically, will the MCC balance the goal of letting countries set their own priorities with the need to ensure that our assistance dollars are being spent on projects we consider priorities?

Answer. As investors using U.S. taxpayer dollars, we are not pushing any particular sector or project, but instead MCC seeks to help countries find the best investment opportunities for poverty reduction and growth. By design, MCC is focused on the poorest countries in the world. The MCC wants to give these countries an opportunity to escape the cycle of dependency and actively change the economic path of their country and part of our strategy is that this is best accomplished by allowing them to take ownership of the success of the program. In order to reflect the priorities of a country—not just the government—MCC places a strong emphasis on civic and private sector participation in setting priorities and then implementing these priorities. We will evaluate program proposals on that basis. We will also evaluate whether the proposed programs will lead to broad based poverty reduction and economic growth based on concrete evidence.

*Question 5.* As I understand it, the MCC is not making any proposals available to the public until a compact has been finalized. Some country governments have made their proposals public; however, many have not. In the spirit of transparency and for the sake of encouraging the continued engagement of civil society, will you encourage governments to make their proposals public?

Answer. Transparency in the countries’ proposal development process is a fundamental MCC principle. MCC requires that all proposals reflect the results of a broad-based consultative process within the country that includes civil society and

the private sector. MCC encourages countries to make their proposals public; however, the final decision as to when to make a proposal public is up to the countries themselves.

*Question 6.* The MCC just announced seven countries as eligible to participate in the MCA Threshold Program. How were these countries selected? In particular, why was Uganda selected? The government in power intends to push a constitutional change to allow President Yoweri Museveni—who has been in power since 1986—to run for a third term, despite consistent and concerted diplomatic efforts by the U.S. government to encourage President Museveni to step down.

*Answer.* The Threshold Program is directed toward a limited number of countries that have not yet qualified for Millennium Challenge Account (MCA) assistance but have demonstrated a significant commitment to meeting the eligibility criteria. The Threshold Program is designed as an added incentive to countries committed to reform, and will be used to assist such countries in moving toward future MCA eligibility. Participation in the Threshold Program does not guarantee that a country will become eligible for MCA assistance in the future. Likewise, countries may become eligible for future MCA funding without participating in the Threshold Program.

The Millennium Challenge Corporation's (MCC) Board of Directors recently invited seven countries to apply for FY 2004 MCC Threshold Program assistance: Albania, East Timor, Kenya, Sao Tome and Principe, Tanzania, Uganda, and Yemen. The MCC Board of Directors selected the seven countries as eligible for FY 04 Threshold Program assistance based on their demonstrated commitment to meet the MCA eligibility criteria, including improvement of their scores on sixteen publicly available policy indicators in three general categories: ruling justly, investing in people, and encouraging economic freedom.

In considering countries for the FY 04 Threshold Program, the Board favored countries that had to improve upon two or fewer indicators to qualify cleanly under the MCA eligibility criteria; i.e., by improving on two or fewer indicators the country would score above the median on half of the indicators in each policy category, would score above the median on the corruption indicator and would not score substantially below the median on any indicator. In addition, the Board reviewed whether countries that passed this screen also demonstrated a commitment to undertake policy reforms that would result in improvements in deficient MCC policy indicators. Finally, a Board decision was made to limit the number of threshold countries to 7 to 9 countries due to limited initial resources and program staff at both MCC and USAID.

In the case of Uganda we are aware of the concerns to potential changes in the Ugandan constitution and we will continue to monitor developments closely. It should be emphasized that Uganda's selection as a threshold candidate does not guarantee that funding of any nature will be provided. Rather, all potential threshold candidates will be required to demonstrate that they are willing to take tangible steps to address failing indicators. These types of reforms require leadership and commitment, and the responsibility lies with the countries. If Uganda, and the other threshold candidates, want to undertake this challenge and opportunity then we should be prepared to support their efforts.

*Question 7.* The MCC has conveyed its intention to lower the inflation rate indicator from the 20 percent used in FY 2004 to 15 percent and is considering a further reduction to 10 percent in FY 2006. Can you explain the motivation for lowering the inflation indicator and how lower inflation rates will contribute to the overall MCA goals for sustained economic growth and poverty reduction?

*Answer.* Among a variety of factors in choosing indicators, the MCC is looking for those that have a clear theoretical or empirical link to economic growth and poverty reduction, and are policy-linked. There is a great deal of research that shows that higher rates of inflation are especially harmful to the poor, who are the least able to protect themselves. It is sometimes referred to as a highly regressive tax. In addition, inflation leads to distortions in relative prices and the decisions based on them, which tends to harm the investment climate. Inflation is also clearly an important measure of a country's monetary policy.

MCC's indicators are used to rank country's policies against each other. Given the difficulties of a relative scale to determine an inflation median, MCC has used a hurdle rate for that particular indicator. MCC was concerned that the 20 percent rate used in FY2004 was not as meaningful as originally intended and given the importance of an investment climate and monetary policy to a country's growth potential—we lowered it to 15 percent.

*Question 8.* How will factors such as poverty reduction and economic growth be weighed in determining the merit of a country's MCA proposal? How will you judge a country proposal's effect on short-term and long-term impacts on both poverty and economic growth?

Answer. The goal of the MCA is to reduce poverty. It seeks to do this by increasing the economic growth of recipient countries. This requires an emphasis on investments that raise the productive potential of a country's citizens and firms and help integrate its economy into the global product and capital markets.

A country's proposal should make the link between the program suggested and the desired outcomes, and we will conduct economic analysis to try to determine those impacts. In order to promote a sustainable, long-term economic growth and poverty reduction, in our due diligence process we will also look at issues such as: efforts to mitigate potentially negative environmental impacts; the quality of public consultation and level of public support for the proposed activities; identification of the expected beneficiaries; and the quality and capacity of local entities to manage the funds in an accurate, transparent, and efficient manner to implement the proposal. In addition, we will look at program proposals to see if they have concrete, measurable goals and benchmarks that can be used to assess progress toward those goals and so we can adequately evaluate the impact of the assistance.

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RESPONSES OF HON. PAUL V. APPLGARTH TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR JON S. CORZINE

*Question 1.* What were the criteria used to select the Threshold Countries? What was the basis for determining that each of these countries had demonstrated a "significant commitment" to meeting the eligibility requirements?

Answer. The Threshold Program is a very important part of MCC's Mission. By targeting funds exclusively at policy reform, it is focused on MCC's fundamental objectives. The program is directed toward a limited number of countries that have not yet qualified for Millennium Challenge Account (MCA) assistance but have demonstrated a significant commitment to meeting the eligibility criteria. The Threshold Program is designed as an added incentive to countries committed to reform, and will be used to assist such countries in moving toward future MCA eligibility. Participation in the Threshold Program does not guarantee that a country will become eligible for MCA assistance in the future. Likewise, countries may become eligible for future MCA funding without participating in the Threshold Program.

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*Question 2.* Please describe the relative roles of the MCC, USAID and any other government agencies in administering Threshold Country assistance. How will this assistance be structured to achieve the goal established in the MCA legislation of helping each country become fully eligible for MCA assistance? For instance, will countries that do not meet the criteria with regard to corruption but have demonstrated a commitment to reform receive assistance in the form of anti-corruption programs?

Answer. The U.S. Agency for International Development (USAID), in partnership with MCC, will take the lead in implementing the Threshold Program. Other U.S. agencies and departments may play an implementation role as well.



Countries that have been selected by the Board as eligible for FY04 Threshold Program assistance have been invited to submit proposals for policy and other reforms necessary to improve performance on the indicators. MCC and USAID, along with other U.S. agencies where appropriate, will then evaluate proposals and determine which of these proposals merit MCC funding. The evaluation process will be rigorous and there is no guarantee that a Threshold Program will be approved and funded.

Qualifying for the MCA will continue to depend on a country's performance on the MCA selection criteria. Change will not be easy and it may take time for improvements to be reflected in a country's indicator scores. Improving performance on the MCA indicators will require strong political commitment and leadership over a sustained period of time. Specifically, in regards to the corruption indicator, we would expect countries that performed poorly on this indicator would make this a central focus of their threshold program proposals.

*Question 3.* Please describe efforts to make the compact process transparent in each of the eligible countries? What policies does the MCC have in place to promote transparency, e.g. outreach to civil society, posting of information on government web sites?

Answer. MCC has made clear to governments, as well as their citizens, that the quality of the process used to set development priorities for MCA assistance will be an important factor in our evaluation of their program proposals. To reinforce that message, MCC has posted its guidance for developing a program proposal on the web in local languages of the eligible countries, making the guidance available to potential participants in the consultative process. MCC staff has visited all of the eligible countries—some several times—and has met with a broad range of society including the private sector, NGOs, representatives of civil society, parliamentarians, opposition parties and others to determine whether they had a meaningful opportunity to participate in the process. We have used the media (radio, TV, and print) to reach out to a broad base of citizens in eligible countries. Finally, we maintain a regular dialogue with U.S. and international NGOs working in these countries, who are supportive of this process and are working with local NGOs to improve their capacity to participate.

Based on feedback from these groups, for example, we have recently included on our Web site a link to eligible countries' government points of contact and their Web site. Some governments have already posted their program proposals on their Web sites to enable public comment. Once we have reached a Compact agreement with countries, it will be posted on MCC's Web site.

*Question 4.* Has the MCC considered incorporating within its compacts a concrete role for civil society and NGOs to assist in the monitoring and evaluation of projects?

Answer. MCC believes that civil society and NGOs have an important role in the monitoring and evaluation of projects—whether formally or informally—which is a key reason for posting Compact agreements on the web and other means to make them publicly available. Making the specific program and budget information publicly available will enable the intended beneficiaries and other interested parties to monitor progress. Eligible countries are to propose the monitoring and evaluation system that will be employed on the program. This may rely on NGOs for monitoring and evaluation work, depending on government and NGO capacity. MCC will evaluate the monitoring and evaluation plans and capacity, as part of the overall review of the program proposal.

*Question 5.* Has the MCC considered developing a tool for direct feedback, either through the Internet or via a civil society forum, from individual citizens and NGOs in recipient countries who witness waste, fraud or misuse of funds?

Answer. We are working with U.S. and international NGOs that have in-country offices and good contacts within these countries. We have also developed direct communications with NGOs, civil society groups, private-sector individuals, and individual citizens in the countries and have encouraged them to provide this type of feedback once a program has been initiated. We have a web-based mechanism for submitting comments and questions and have already received helpful feedback. USAID Missions and U.S. Embassies have served as an additional vehicle for communicating questions, concerns or comments and it is likely that MCC will post one or more representatives in some of the Compact countries.

