



**The Impact of FY2008 Funding Options on the Millennium Challenge Account:
From Saving Face to Saving the Program**

Sheila Herrling¹

November 16, 2007

On November 13, the President signed another continuing resolution to keep the federal government operating at FY07 spending levels until December 14. Congress and the White House remain at odds over spending in almost every bill. Several bills are moving forward to the President at this time, but the \$34.2 billion² State, Foreign Operations and Related Programs bill that contains the International Affairs budget -- the "150 Account" -- is not among them nor are there plans for a conference committee to hash out the differences between the House and Senate versions of the bill.³ And the President continues his threats to veto 10 of the remaining 11 spending bills. The most likely outcome is that the State Foreign Operations bill will become part of a comprehensive omnibus bill, where it may be vulnerable to across the board cuts during budget negotiations.

A lower overall International Affairs budget will make existing funding differences and trade-offs on strategic priorities even more striking. In a federal budget dominated by defense and domestic spending, every penny of the international affairs budget—particularly development assistance—will be hard fought. If history is any guide, Congress is likely to balance the FY08 federal budget by cutting development assistance, save perhaps expenditures related to global health pandemics. Yet core development assistance—long-term investments in the prevention of poverty and instability—remains under-prioritized despite being a key component of U.S. national security and global influence, reducing the strain on national defense, and helping to make the world a safer and healthier place.

¹ Sheila Herrling is a Senior Policy Analyst and Manager of the MCA Monitor at CGD.

² Combined with funding of \$1.3 billion for international food aid programs and a \$300 million contribution to the Global Fund to Fight AIDS, Tuberculosis and Malaria, the budget is \$35.8 billion. On November 12, the President vetoed the Labor-HHS bill which included the Global Fund contribution because it exceeded his \$933 billion discretionary spending ceiling.

³ On September 6, the Senate approved a \$34.2 billion FY08 State, Foreign Operations and Related Programs Appropriations bill. While the Senate and House bill provide the same overall funding level, there are specific account funding and policy differences that would typically be negotiated by a conference committee. The President's original budget request was \$36.5 billion, followed by an additional \$3.3 billion GWOT supplemental.

Particularly vulnerable in the International Affairs budget each year is the Millennium Challenge Account (MCA), one of few U.S. foreign aid programs specifically targeted to long-term development objectives. Although the President requested a \$3 billion MCA budget, the House approved \$1.8 billion and the Senate approved \$1.2 billion. Both bills reflect Congressional discomfort over large, undisbursed MCA obligations that could be spent elsewhere now.⁴ Without a conference committee planned, it is unclear how the funding and policy differences between the House and Senate, as well as an amendment introduced by Senator Lugar to change the MCA's compact funding obligations policy (see below), will be negotiated.

The Impact of Various Funding Options on the MCA

As Appendix 1 shows, the difference between the House and Senate funding levels will have a substantial impact on countries that have worked hard to meet the requirements of the MCA program. Senator Lugar's amendment, which allows the U.S. to save face with those countries, sacrifices a key innovation of the MCA program -- rooted in lessons on effective development assistance -- that distinguishes it from other U.S. foreign aid programs.

The \$1.8 Billion House Version: Saves Face, Keeps MCA Principles Intact

The House appropriation of \$1.8 billion would allow the MCA to sign all four compacts expected to be finalized by end-FY08 -- Mongolia (signed), Tanzania (approved but unsigned pending funds), Burkina Faso (in final stage of due diligence) and Namibia (in final stage of due diligence). The countries that met the challenge of passing the indicators and designing a strong program will, therefore, receive promised MCA funding. In addition, it provides sufficient funding for the MCA Threshold Program, a program which can use up to ten percent of the annual appropriation to fund smaller grants to selected countries to help them meet the requirements for full compact eligibility.

The \$1.2 Billion Senate Version: Loses Face, Puts MCA Principles at Risk

The Senate bill report language claims to support an overall funding level that covers the four compacts expected to be finalized by end-FY08. However, at currently projected levels, \$1.2 billion will only cover three of the four (even without new threshold programs). Based on current negotiation projections, the impact will most likely hit Burkina Faso where hard-fought reforms and pre-compact feasibility studies funded with their own resources to address timing delays that have affected other compacts, will go

⁴ For more information on tracking obligations versus commitments and disbursements, see Sheila Herrling and Sarah Rose, "Will the Millennium Challenge Account Be Caught in the Crosshairs?" MCA Monitor Analysis (Washington DC: Center for Global Development, March 2007).
<http://www.cgdev.org/content/publications/detail/13398/>

MCA Monitor Analysis

unrewarded. more specifically, the Burkinabe who have been both making progress on an MCA Threshold program and working with the government to prepare a compact would need to wait another year to receive funding. This will send a strong and chilling signal to countries that if they meet the MCA standards and design a strong program, there is significant risk that the U.S. will not fund the program. This could begin to erode the “MCA effect” as an incentive for strong policy reform.

The Lugar Amendment: Saves Face, Sacrifices MCA Principles

The Senate also approved unanimously an amendment by Senator Lugar that changes the current stipulation requiring the MCC to obligate the entirety of funds for approved compacts at the time of their signing to require that "not more than 50 percent of the entire amount anticipated for the duration of the compact" be obligated upfront. That does a couple of things. First, it technically allows the MCC to sign compacts with the four countries cited above, and more. (Although it remains unclear whether the MCC would, or should, take that path.) And, going forward, it would make the overall balance sheet optics a little better, essentially halving the current large undisbursed balances which would, theoretically, reduce the “poachability” of the MCA each budget cycle. The simple reality from the perspective of appropriators is that even if they support the concept of the MCA, they will see the opportunity costs (needs today) of hundreds of millions of dollars waiting to be spent in the future.

And yet, the MCA was specifically designed to challenge the business-as-usual allocation and appropriation systems of U.S. foreign aid. The Lugar amendment removes two key innovations purposefully addressed in the founding concept of the MCA program:

- First, it would erode the founding principle of making aid flows more predictable, purposefully accommodated in the MCA’s design based on the internationally-endorsed Paris Declaration of Aid Effectiveness.⁵ The idea was that countries that performed well enough to get into the program, that then worked with their citizens to design a credible development program, and that met performance benchmarks during implementation would know with certainty that funding for the program they designed was guaranteed and was not at risk of being redirected to other foreign aid programs. Countries have been told that this “predictability-with-performance element” distinguishes the MCA program from USAID and countries have responded. Removing this innovation could impact how incentives for sustained reform work.
- Second, it would eliminate decision making accountability to the *sitting* Congress. In other words, the MCA principle of setting aside the entirety of MCA compact funding at signing aimed also to avoid the irritation that future Congresses have historically had with being put in the position of approving funding to continue programs they did not approve at the outset.

⁵ <http://www1.worldbank.org/harmonization/Paris/FINALPARISDECLARATION.pdf>

MCA Monitor Analysis

Proponents of the Lugar amendment believe it is necessary to protect both future MCA funding levels and the reputation of the MCC by allowing it to continue negotiations with countries in the final stages of compact preparation. On the latter, it will allow the MCC to sign more compacts, however, it puts at risk funding for the end-years of those compacts. Although it has not common practice for the U.S. to renege its bilateral aid commitments, the world is a much different place today. With short-term security interests dominating the political landscape, the future of foreign aid, particularly foreign aid for long-term development programs, is substantially more at risk. Indeed, this year the lion's share of U.S. foreign aid goes to ten countries, the majority of which are geopolitical allies in the war on terror or drugs. A rising deficit will continue to put pressure on international affairs spending, and maintaining political allies has trumped development spending to date. The cost of saving face – not having to turn countries away at the finish line -- may be the very core of what distinguished the MCA from the pack. Proceeding along these political lines is a slippery slope toward programmatic conventionalism. Lastly, the argument that the amendment protects future MCA funding levels falls flat. It continues to put pressure on the MCA to approve new compacts instead of addressing implementation issues and delivering results on the ground.

A Path Forward

Instead of an accounting maneuver that allows the MCA to sign more compacts, Congress and the Administration should work together to elevate the importance of development policy and programs in our national interest and address the legitimate concerns on slow MCA implementation. In the FY08 budget, Congress should:

- Provide at least \$1.6 billion to the MCA to allow it to fund FY08 compacts to countries that are at the finish line (Tanzania, Namibia and Burkina Faso). \$1.8 would allow funding of new Threshold Programs.
- Withdraw the Lugar Amendment.
- Introduce an amendment that allows concurrent compacts – that is, allow countries to have more than one compact in force at one time. This would reduce the complexity of current compacts and allow sequenced reform programs that could speed up implementation and disbursement.
- Signal that global development is a national priority – the right and smart thing to do – and that the MCA program, including its unique funding obligation construct, should be given a chance to demonstrate its effectiveness. Recognize that potentially the greatest innovation of the MCA is that it creates a new kind of political ally – America's model partners in the war on global poverty and instability.

At the same time, the MCC should:

- Reset expectations on the time it takes to stay true to a model of country-owned and country-implemented development programs. The MCC should acknowledge

MCA Monitor Analysis

that the presumption at the outset of the program that the set of countries eligible for MCA funding would have the management capacity and fiduciary standards necessary to accountably implement the programs was optimistic and has been part of the reason for slow implementation. It takes time for recipients to discuss, debate with their citizens, and build consensus around programs; write strong proposals; and put in place all the necessary oversight arrangements, especially since most donors have not asked them to do this in the past. Building this capacity is a really good thing in the long run (both for the countries and for the future results of the MCC program), and is one of the key ways in which the MCC could distinguish itself as a strong model for foreign assistance, but it is affecting early disbursements.

- Shift its operational model to focus strategically and strongly on implementation. The recent reorganization that symbolizes such a shift needs to be complemented with streamlined decision making processes that do not sacrifice environmental, social and fiduciary safeguards, and maintains a strong focus on results.
- Consider phasing in performance-based budget support to countries that meet a high accountability standard and deliver results.
- Introduce operational processes *after country selection* that allow scarce MCA resources in the compact development unit to be directed to countries that distinguish themselves as most serious. For example, deadlines for proposal submittal, or early concept papers that provide a sense of country understanding of its constraints to growth and commitment to the MCA process.
- Enhance its public outreach and communications strategy in terms of telling the extremely important institution building stories that in the short-term impact disbursement rates but in the long-term are the foundation for long-term success and MCA innovation.