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EXPLAINERS

LKI *Explainers* examine an aspect of Sri Lanka's international relations.

The Millennium Challenge Corporation and Sri Lanka

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The Millennium Challenge Corporation (MCC) recently approved a five-year grant as part of a Compact programme for Sri Lanka. This LKI Explainer looks at the MCC Compact process and other international recipients of MCC grants. It also breaks down the details of Sri Lanka's proposed MCC Compact and highlights the implications for the country.

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1. What is the Millennium Challenge Corporation?

- The Millennium Challenge Corporation[1] (MCC) is a bilateral US foreign aid agency established by the US Congress in 2004. It is an independent agency, separate from the State Department and USAID.

- The MCC Board of Directors is comprised of the Secretary of State[2] (Chair), Secretary of the Treasury, US Trade Representative, Administrator of USAID, CEO of MCC, and four private sector members appointed by the US President with the advice and consent of the US Senate.

- The MCC is different to other US aid agencies[3] as it has a competitive selection process that rewards countries for their commitment to free market economic and democratic policies, as measured by objective performance indicators. It also requires program proposals to be developed and implemented by qualifying countries with broad-based civil society involvement.

- The MCC provides time-limited grants focused on promoting economic growth, reducing poverty, and strengthening institutions. This is only available to developing countries that are committed to good governance, economic freedom and investing in their citizens.

- There are three types of MCC grants:
  - Compacts: Five-year grants for countries that meet MCC's eligibility criteria.[4]
  - Concurrent Compacts for Regional Investments: Grants that promote cross-border economic integration.[5]
  - Threshold Programs: Smaller grants for countries that come close to passing MCC's eligibility criteria and show commitment to improving their policy performance.[6]

- As of July 2019, MCC has completed 25 Compacts [7] since its founding, worth a total USD 8.8 billion in 23 countries across Africa, Asia, Eastern Europe, Latin America, and the Pacific. Ten more Compacts, worth USD 4.2 billion, are being implemented or have been signed ahead of implementation, and an additional eight are in development.

- During the same period, MCC has completed 24 Threshold Programs,[8] worth a total of USD 0.5 billion, in 22 countries across the same regions. An additional four Threshold Programs, worth USD 0.2 billion, are being implemented, and three are in development.

- In comparison, USAID spent over USD 20 billion in 139 countries around the world during the 2018 fiscal year[9] alone.

2. MCC Compact Process

- Potential candidate countries are identified[10] based on their classification as low or middle income country by the World Bank,[11] as well as not being subject to US or international sanctions.

- Candidate countries are then evaluated on three factors,[12] namely:
  - Performance in MCC's 20 quantifiable policy indicators,[13] which measure the relative strength of national policies in encouraging economic freedom, investing in people, and ruling justly;
  - Opportunity to reduce poverty and generate economic growth; and
  - Availability of MCC funding.

- Once a country is selected to develop a Compact,[14] it is required to conduct a thorough study of the binding constraints to sustainable economic growth and the reduction, including extensive stakeholder consultations. This is followed by the development of projects to address key constraints and negotiations with MCC to reach an agreement on specific activities, budget and other monitoring arrangements. This process generally takes 2-3 years.

- The development of the compact is led by a Compact Development Team[15] appointed by the government of the selected country. This will include an experienced, full-time national coordinator supported by a staff of well-qualified experts and technical specialists.

- When a country is awarded an MCC Compact, the government is required to set up a local accountable entity to manage and oversee all aspects of implementation. These entities known as Millennium Challenge Accounts (MCAs),[16] are managed and largely staffed by country nationals, and often work directly with existing government ministries.
  - MCAs handle all procurement in line with MCC's Program Procurement Guidelines, which are based on international procurement standards.

- MCC may suspend or terminate the Compact[17] if it determines that the country (1) is engaged in activities which are contrary to the national security interests of the US; (2) has engaged in a pattern of actions inconsistent with the criteria used to determine the eligibility of the country; or (3) has failed to adhere to its responsibilities under its Compact.

3. Country Experiences of MCC Grants

- MCC has been commended for addressing key issues related to aid effectiveness.[18] This includes having a clear single objective, emphasising country ownership, using rigorous economic analysis to choose projects, and focusing on ensuring and evaluating the results of projects.

- However, it has also been criticised for being partially driven by the diplomatic interest of the US,[19] not being transparent enough[20] about the evaluation process, and not ensuring broad enough stakeholder consultation.[21]

- A successful example of an MCC compact is the Philippines Compact,[22] which involved three projects worth a total of USD 400 million and ran between 2011 and 2016. The projects included:
    - The modernisation of the Bureau of Internal Revenue;
    - The expansion of community-driven development projects; and
    - The rehabilitation of a critical secondary national road.

- As a result of the Philippines compact, USD 300 million in additional domestic tax revenue was collected between 2013 and 2016, 4,000 small-scale community-driven development projects were completed, and 222 km of a critical national road were rehabilitated.

- MCC has terminated compacts on two occasions; a compact with Madagascar was terminated in 2009 due to an undemocratic transfer of power,[23] while a compact with Mali was terminated in 2012 following a military coup.[24] In 2016, the development of a compact with Tanzania was suspended[25] by the MCC board due to concerns over democratic rights in Zanzibar.

4. Sri Lanka's Proposed MCC Compact

- The MCC Board of Directors approved a five-year, USD 480 million compact with Sri Lanka in April 2019. This followed the MCC Board's decision to select Sri Lanka to develop a compact in December 2016.

- A 2017 Constraint Analysis Report[26] prepared by the Government of Sri Lanka and MCC (in partnership with Harvard University's Center for International Development), identified three binding constraints to economic growth;
    - Policy uncertainty, especially regarding revenue collection and tax policy;
    - Transport bottlenecks, particularly in the Western Province; and

- The difficulty of the private sector in accessing land for commercial purposes.

- Reflecting the results of the constraint analysis, the proposed compact includes two projects; a Transport Project and a Land Project. Table 1 provides a breakdown of the budget.

Table 1: Budget of Proposed Sri Lanka

Component	**Total (USD Millions)**
1.Transport Project	
1.1 Advanced Traffic Management System	159.9
1.2 Bus Transport Modernisation	50.0
1.3 Central Ring Road Network	140.1
Subtotal	**350.0**
2. Land Project	
2.1 Parcel Fabric and State Land Inventory	23.4
2.2 Deeds Registry Improvement	11.4
2.3 Land Valuation System Improvement	6.5
2.4 Land Grants Registration and Deed Conversion	19.3
2.5 Land Policy and Legal Governance Improvement	6.7
Subtotal	**67.3**
3. Monitoring and Evaluation	**12.7**
4. Program Administration and Oversight	**50.0**
TOTAL BUDGET	**480.0**

Source: Millennium Challenge Corporation, 2019

- The Transport Project aims to increase the efficiency and capacity of the road network and bus system in the Colombo Metropolitan Region. It includes three activities:
    - *Advanced Traffic Management System*: Includes improvements to approximately 132 junctions and totalling up to 50 pedestrian crossings, as well as the creation of a traffic management centre to optimise the efficiency of the existing road network.
    - *Bus Transport Service Modernisation*: Focuses primarily on institutional and regulatory reforms, such as improvements in bus route planning and scheduling.
    - *Central Ring Road Network*: Aims to reduce transport costs by improving five sections of the road network connecting Central, Sabaragamuwa, Uva, and the Eastern Provinces to the Western Province.

- The Land Project (USD 67.3 million) seeks to improve access to private and state land, provide more uniform valuation of land, and assist the Government in improving the land policy and governance framework under which land is managed and administered. It includes five activities:
    - *Parcel Fabric Map and State Land Inventory*: Proposes to create a parcel fabric map for 28% of land area in Sri Lanka to assist in the completion of an inventory of state lands.
    - *Deeds Registry Improvement*: Assisting the Land Registrar's Office to convert paper-based records to a digital format.
    - *Land Valuation System Improvement*: Focuses on scanning and digitisation of key information from valuation files for properties in targeted districts.
    - *Land Grants Registration and Deed Conversion*: Aims to strengthen tenure security by supporting the conversion of State Lands to the private domain, creating a marketable and bankable title to this land in the name of the landholder.
    - *Land Policy and Legal Governance Improvement Activity*: Aims to establish a land policy council that will direct policy studies and support the government's efforts to adopt a new land policy and enact supporting legislation, among other activities.

- These projects would be fully implemented by the Sri Lankan government through a local MCA.

5. Implications of the Sri Lanka MCC Compact

- The USD 480 MCC Compact is a grant, rather than a loan. As such, it places no financial burden on the Sri Lankan government or people.

- It is also large relative to the USD 21 million in grants Sri Lanka received in 2018.[27] What's more, grants to Sri Lanka from other sources are likely to decrease over the coming years as it was recently classified as an upper-middle income country by the World Bank.

- However, the MCC Compact is still small compared to Sri Lanka's total foreign financing needs. In 2018, Sri Lanka obtained USD 4.9 billion in foreign financing, which included USD 1.4 billion in loans and grants,[28] USD 2.5 billion in international sovereign bond issuances,[29] and USD 1 billion through a Foreign Currency Term Financing[30] from China Development Bank.

- Sri Lanka leads implementation of the compact, and therefore, has full control over project implementation. The MCC requires regular progress updates to ensure transparent use of the funds.

- Critics of the MCC Sri Lanka Compact have raised a host of legal, environmental and external political interference issues.[31]

- An assessment of the compact based on Sri Lanka's economic interests,[32] suggests that the MCC Compact could provide net benefits for the country's development. It is free money, diversifies the sources of development finance, and would help to improve transport for the poor. If concerns regarding project priorities, overheads, and consultations could be reflected during implementation, it may be a better MCC Compact for Sri Lanka.

Notes

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