Timor-Leste Seeks Millennium Challenge Funding from Washington

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Four years ago, the Bush Administration began to deliver U.S. foreign aid in a new way. Rooted in free-market ideology and utilizing the testing preoccupation of No Child Left Behind, the Millennium Challenge Corporation (MCC) bypasses USAID, the main foreign aid agency, to create direct aid linkages between Washington and selected underdeveloped countries. Timor-Leste barely qualified for this program for 2008 (and will likely fail for 2009), and Dili is currently negotiating the details with Washington.

Despite its name, the MCC is a U.S. government agency that administers foreign assistance programs using the Millennium Challenge Account (MCA). Termed an "independent government corporation," the MCC is funded by the U.S. Congress as part of the State Department budget. Its mission is "poverty reduction through sustainable economic growth," which President Bush has characterized as "providing greater resources to countries taking greater responsibility for their own development." In practice, this means that the U.S. rewards low-income countries for combating corruption and opening their economies to global market forces, private investors and unrestricted trade.

MCA will support a country for a single five-year period, according to a "Compact" agreement which defines the specific projects and amount of money. Sixteen countries have received funding so far: two in Eastern Europe, two in Asia/Pacific, three in Latin America and nine in Africa. During the past four years, more than five billion dollars have been committed, ranging from $700 million each for Tanzania and Morocco to $66 million for Vanuatu.

Test scores

In order to receive MCA money, a government must pass a test every year, which is meant to confirm that the government has implemented reforms and that the assistance will yield results. The recipient country must score above the global median on selected indicators from intergovernmental and private agencies. Given the choice and tabulators of these indicators, the Bush administration's political goals are built-in, guided by the "Washington Consensus" that small countries must not protect their economies from global market forces.

To be eligible for Compact funding, a country must score better than half of the low and moderate income countries on the World Bank Institute's corruption index, as well as on a majority of indicators in each of three categories:

1. Ruling justly: civil & political rights (Freedom House), rule of law (World Bank), accountability (WB), government effectiveness (WB)
2. Investing in people: effective spending on health (WHO) and education (UNESCO), natural resources management (Columbia & Yale)
3. Economic freedom: regulation (WB), land rights (IFAD), business start-up (IFC), trade policy (Heritage Foundation), inflation (IMF)

Timor-Leste and the MCC

Timor-Leste became eligible for MCA threshold funding in 2004, which could have helped it meet full MCC eligibility, but the Dili government failed to complete the process. However, Timor-Leste's indicators (which usually indicate conditions two years earlier) qualified it for full MCA "Compact eligibility" as a "low-income country" in 2006.

In February 2007, Timor-Leste submitted a Compact proposal to the MCC, including projects in transportation, power, water, sanitation, vocational education and private sector development. After some negotiation, the MCC rejected the proposal because it was too unfocused, too ambitious, and put together without public consultation. In addition to requiring community based discussion prior to a proposal's submission, Washington prefers that a proposal address only one or two key constraints to economic growth.

After the June 2007 Timor-Leste election, the new Government could have submitted a new proposal to MCC, but did not. When Washington later tabulated the indicators for 2008 Compact eligibility, Timor-Leste failed the corruption indicator, as well as three of five "investing in people" scores and three of six "economic freedom" scores, which would make it ineligible. However, the Timor-Leste Government and U.S. Ambassador to Timor-Leste Hans Klemm persuaded the MCC Board that the poor results reflected the 2006 crisis (which occurred during a previous government), and that the process discriminates against countries emerging from conflict. Furthermore, the scoring for Timor-Leste was flawed because data was absent for two indicators. In early December 2007, the MCC Board bent the rules and continued Timor-Leste's Compact eligibility for 2008.

Eligibility

Although MCC eligibility for 2009 won't be decided until December, it seems unlikely that Timor-Leste will qualify. Not only have its scores slipped for Corruption (from 43rd to 39th percentile), Rule of Law, and Government Effectiveness, but Timor-Leste recently fell 22 places in Transparency International's perception of corruption rating. Although the TI index isn't officially used by MCC, it confirms the World Bank's tabulation that corruption is increasing. (Each of these indicators is derived from data from 2007 or earlier, but they will determine eligibility for 2009.)

Nevertheless, Timor-Leste's Ministry of Finance, led by João Mariano Saldanha, continues work on a on the Compact. For the U.S. side, former foreign service officer and investment banker Darius Nassiry is MCC Country Director for Timor-Leste. The Washington and Dili contacts met at least four times during 2008, twice in each city.

Timor-Leste has a two-pronged strategy to obtain MCC funding:

1. Strengthen performance on weak indicators by improving government policies, integrating community health services, enacting business legislation, cutting corporate and import taxes, and establishing land title laws. To date, taxes have been slashed, but most other measures, including control of corruption are mainly well-intentioned promises.

2. Follow the MCC process rigorously, including a recently completed "constraints analysis," public consultations, a Concept Paper in November, and a Compact proposal submitted by April 2009, which hopefully will be signed in August. If Timor-Leste fails eligibility for 2009, they hope to continue the compact signing process, in order to receive funds when they become re-eligible in 2010, but MCC may not accept this.

Timor-Leste's compact proposal will probably be for roads, and may also include vocational education centers. If MCC accepts it, Washington could give Timor-Leste around $200 million over the next five years, of which the Timor-Leste Government will match about 10%. This is a lot of money for this small country; the government budget for 2008 is $788 million, more than triple the previous year. Once the Compact is signed, Timor-Leste's Government will implement it under MCC "guidance and oversight" and previously-agreed fiscal accountability structures.

While Timor-Leste hopes to move full steam ahead, the U.S. Congress is less confident in the MCC. In July, the Senate decimated MCC's funding, appropriating only 11% of the $2.2 billion requested by the Administration for fiscal year 2009. The Senate also wants to prohibit the MCC from signing new compacts next year, with a loophole for "countries important to U.S. interests" (unlikely to include Timor-Leste). For the future, the Senate committee "recommends the incoming administration re-evaluate MCC's needs." Although the House and the full Congress have not yet endorsed the Senate's cuts, and the State Department Appropriations Bill may not pass this year (which would likely continue MCC appropriations at FY2008 levels), the program's future is in doubt.

Concerns

- Early in 2008, Senators Barack Obama and John McCain both promised to continue George Bush's Millennium Challenge Account initiative, notwithstanding the program's deficiencies, but subsequent developments (including the Senate report and the financial industry bailout) have put their commitments into question.
- In addition to the ideological bias and subjectivity of some indicators, MCC circumvents in-country USAID staff and diplomats who have greater country-specific knowledge and experience than Washington-based MCC officials.
- MCC is a one-shot program limited to five years. While this could provide impetus for further development, it has no sustainability, and does little to build local capacity or to ensure that MCC-funded infrastructure will be maintained.
- MCC has no preference for purchasing local goods or employing local citizens. Most funding will not likely enter the Timorese economy, repeating the pattern set by other UN and foreign aid programs. A visiting MCC official told Timor-Leste NGOs that Timor-Leste will get the infrastructure, even if the money and jobs go elsewhere.

Since mid-2008, MCC has become a political football in Dili, with opposition politicians using MCC as a club to blame the new government for corruption. Although the pressure for high test scores could be an incentive for better governance, it might lead Dili to sacrifice MCC funding for short-sighted, short-term policies. After all, $200 million is only two month's revenue from the Bayu-Undan oil and gas field, and, as demonstrated by the 126% increase in a "mid-year budget adjustment," Timor-Leste's current Government wants to spend money quickly, apparently regardless of the benefits or consequences.