CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform the Congress of our intent to provide funding of up to $277,000,000 under a Millennium Challenge Compact with the Government of El Salvador.

This notification is being sent to the Congress on September 19, 2013.

Obligation of funds may be incurred on or after 15 days from the date of this notification.

An attached summary describes the project and other key elements of the planned Compact. If you or your staff would like to arrange a meeting to discuss the Compact, please contact me or Jim Mazzarella, Managing Director of Congressional Affairs, at (202) 521-3850.

Sincerely,

/s/
Paul Weinberger
Vice President
Congressional and Public Affairs

Enclosure:
As stated

MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION
September 19, 2013

PROGRAM:	Eligible Countries
APPROPRIATIONS CATEGORY:	Fiscal Years 2007, 2012 and 2013 Program Funds
OBLIGATION AMOUNT:	$277,000,000

Pursuant to (i) section 515 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2006, as carried forward by the Revised Continuing Appropriations Resolution, 2007, (ii) section 7015(c) and the heading "Millennium Challenge Corporation" of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2012, and (iii) section 7015(c) and the heading "Millennium Challenge Corporation" of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2012, as carried forward by the Full-Year Continuing Appropriations Act, 2013, the Millennium Challenge Corporation ("MCC") wishes to notify the Congress of its intent to sign a Millennium Challenge Compact (the "Compact") with the Government of the Republic of El Salvador, through which MCC will grant up to a total amount of $277,000,000 to the Government of El Salvador under the Millennium Challenge Act of 2003, as amended (the "Act"). To accelerate implementation of the Compact, MCC intends to obligate up to $10,000,000 ("Compact Implementation Funding") of the overall grant under section 609(g) of the Act, using fiscal year 2013 funds, when the Compact is signed by the parties. Under section 605 of the Act, MCC intends to obligate up to $150,000,000 using fiscal year 2013 funds, $109,000,000 using fiscal year 2012 funds, and $8,000,000 using fiscal year 2007 funds when the Compact enters into force. After the Compact enters into force, Compact Implementation Funding that is not needed to accelerate implementation of the Compact may be deobligated, and up to an equivalent amount of funding may be obligated under section 605 of the Act. Such funding is included in the total amount of MCC funds under the Compact and will not increase the total Compact funding.

Compact funding will support increasing El Salvador's productivity and competitiveness in international markets through investments in El Salvador's investment climate, human capital and logistical infrastructure.

SUPPLEMENTAL INFORMATION
MCC COMPACT DEVELOPMENT WITH EL SALVADOR

Overview

The Millennium Challenge Corporation's Board of Directors (Board) has approved a five-year $277 million compact (Compact) with the Government of El Salvador that seeks to strengthen the investment climate, enhance the role of public-private partnerships in delivering key services, and improve the country's productivity and competitiveness in international markets. Through intensive policy reforms and an integrated set of investments in the human capital, physical capital, and institutional capital of El Salvador, MCC expects that the Compact will help set the foundation for lasting economic growth and poverty reduction.

Background

This Compact will build on the Government of El Salvador's reforms and initiatives and is informed by consultations with over 200 businesses, to invest in the **institutional capital** of El Salvador and enhance the investment climate. First, the Compact will invest in streamlining the regulatory environment and support the implementation of a recently passed public-private partnership law in order to ease the cost of doing business and increase private investment. Second, the Compact will support policy reforms and invest in **human capital** to improve education quality and better match workforce skills with the demands of the labor market. Third, the Compact will invest in **physical capital**, primarily road segments in major transport corridors, to reduce logistics and transportation costs.

The Compact's three projects represent a total investment of $365.2 million, of which MCC will contribute $277 million, and the Government of El Salvador (GoES) will commit $88.2 million – a 32% matching contribution that is well above the 15% MCC requirement for second compacts with lower-middle income countries.

Program Overview and Budget

Below is a summary describing the components of the Compact. The budget and expected impacts are preliminary based on due diligence and project appraisal.

Compact Budget Overview

Project	MCC Funding	GoES Funding	Total Investment	% of Budget
	Millions of US$			
Investment Climate Project	42.4	50.0	92.4	25.3%
Human Capital Project	100.7	15.0	115.7	31.7%
Logistical Infrastructure Project	109.6	15.7	125.3	34.3%
Monitoring and Evaluation	4.3		4.3	1.2%
Program Administration	20.0	7.5	27.5	7.5%
TOTAL	**$277.0**	**$88.2**	**$365.2**	**100%**

Summary of Projects and Activities

Investment Climate Project

The constraints analysis and consultations with investors identified excessive red tape and discretionary application of rules as negatively affecting the investment climate in El Salvador. Firms also identified the need for key public infrastructure to increase productivity, but tight fiscal constraints and weak institutional capacity limit the ability of the GoES to provide such infrastructure. These obstacles to investment have been exacerbated in recent years due to a rift between the GoES and the private sector. The Investment Climate Project seeks to address these deficiencies in El Salvador's investment climate by improving El Salvador's regulatory environment and institutional capacity and providing key public services in partnership with the private sector through the following two activities:

- The *Regulatory Improvement Activity* will prioritize and promote investment climate reforms with the goal of creating a more efficient and profitable business environment for firms in El Salvador. MCC will support the development of an institutional framework and system, including an independent institution focused on regulatory improvement and the prioritization and implementation of a select set of reforms. The reforms will focus on areas critical to El Salvador's competitiveness in international markets and may include trade facilitation, border crossing and customs procedures, environmental permitting and harmonization of municipal and national regulations. The regulatory improvement institution will also consider the extent to which regulations can be improved to reduce the potential for corruption. In designing and implementing reforms, the institution will ensure that the proposed reforms are consistent with the GoES's obligations under international trade and investment agreements, including CAFTA-DR. As part of the activity, the GoES will commit to review, eliminate and simplify regulations early in the Compact implementation process, to demonstrate a high level of commitment to the reform process that is necessary to achieve a dramatic change in the perceptions of the business climate in El Salvador.

- The *Partnership Development Activity* seeks to enable the GoES to partner with private enterprise in innovative ways to provide critical public services in the face of tight fiscal constraints. The GoES has recently passed several laws to facilitate private investment and trade. Most notably, the GoES legislature unanimously passed a law in May 2013 to allow public-private partnerships (PPPs) in the provision of key public services. MCC will invest in capacity building to properly develop, implement, and monitor such partnerships under this law. MCC will also fund transaction advisory services to develop and tender concessions for two key infrastructure projects – the expansion of the El Salvador International Airport and a wind farm. MCC and the GoES are also sponsoring the El Salvador Investment Challenge (ESIC), a program to more efficiently and transparently allocate limited government resources to public goods needed to support private investment in the international trade of goods and services. The ESIC has already generated 74 investment project proposals, which are being evaluated for the next phase of development. The GoES plans to institutionalize the ESIC as an instrument for attracting private investment in the international trade of goods and services sector and will contribute up to $50 million to the ESIC during the term of the Compact.

The estimated economic rate of return (ERR) for the Investment Climate Project is 18.56 per cent, using a weighted estimate of the calculated ERRs for each activity.

Human Capital Project

The quality of education in El Salvador is below what the country requires to be competitive in world markets. The Human Capital Project is designed to improve the quality of education and to better match the supply of skills relevant to the international trade of goods and services in El Salvador to the demand of the labor market. The project consists of the following two activities:

- The *Education Quality Activity* supports complementary interventions to provide Salvadoran students the benefits of competency-based education, increased classroom time, teachers trained in requisite subject-matters and pedagogical skills, and an institutional and physical environment conducive to learning. MCC's investment will strengthen the national education system by reforming the laws, policies, and operations that govern teacher continuous professional development, student assessment, and information systems. The activity also seeks to strengthen and expand the implementation of the full-time inclusive school model, which increases the school day from 25 to 40 hours per week, in an estimated 55 clusters (schools grouped together), focusing resources on grades 7-12. The curriculum improvement will focus on English, mathematics, science and information technology, and other 21st century learning, innovation, life and career skills.

- The *Technical, Vocational Education and Training* (*TVET) System Reform Activity* seeks to harmonize the skills supplied by private and public TVET providers with the skills demanded by the labor market. The activity will strengthen the national TVET governance system by supporting legal, policy and operational reforms within the system. MCC will support the establishment of a public entity governed by a board comprised of an equal number of public and private sector representatives to provide the legal and institutional framework for an integrated TVET system. The activity will also fund TVET curricula development, with participation from the private sector, career counseling and job-matching services, and the establishment of a framework and standards for accreditation of TVET training organizations and certification of teachers and students. The activity will also strengthen the capacity of the TVET system for identifying labor market trends that will inform the strategic direction of the TVET system, including the establishment of a monitoring and evaluation (M&E) framework and a labor market observatory.

The estimated ERR for the Human Capital Project is 11.35 per cent.

Logistical Infrastructure Project

During consultations for development of the Compact, businesses identified certain transportation and logistics deficiencies as reducing their productivity and competitiveness and expressed the need to expand and rehabilitate key road segments. The Logistical Infrastructure Project comprises two activities designed to reduce logistical and transportation costs and relieve bottlenecks at critical sections along the logistical corridor that connects the main border crossing with Honduras at El Amatillo, the Ports of La Union and Acajutla, and the international airport.

- The *Coastal Highway Expansion Activity* seeks to relieve congestion at the most transited segment (27 kilometers) of El Salvador's coastal highway by expanding this road from two to four lanes. The coastal highway is one of the two most important logistical corridors in the country and connects the country's major logistical nodes, including its two sea ports (La Union and Acajutla) and the airport.

- The *Border Crossing Infrastructure Activity* seeks to relieve the freight and passenger traffic congestion at the border crossing into Honduras at El Amatillo by improving a 5.7 kilometer road leading to the border and modernizing the border-crossing facilities on the Salvadoran side. MCC will invest in the construction of control stations at the border, including buildings, internal access and connecting roads, parking areas, water and sanitation, and other infrastructure components that may be necessary for the effective functioning of these stations.

The estimated ERR for the Logistical Infrastructure Project is 20.31 per cent, using a weighted estimate of the calculated ERRs for each activity.

<u>Program Logic, Expected Results, and Beneficiaries</u>
In order for El Salvador to be competitive and raise productivity in internationally-traded goods and services, the factors of production in El Salvador must be competitive with world markets. Those factors include human capital, physical capital, and often logistics/transportation. The institutional environment can also affect productivity. As a result, the Compact takes a multi-pronged approach to enhance El Salvador's competitiveness in these factors of productivity.

By streamlining the business environment, improving the quality of education, and reducing transportation and logistics costs, MCC's investments are intended to increase the productivity of current firms involved in the trade of international goods and services, which is expected to increase current production (and subsequently, employment). Firms are then expected to invest new revenues in more productive technology to realize greater returns on future production. Higher employment and output are expected over time through this self-reinforcing feedback loop which is enabled by greater productivity in traded goods and services.

The expected beneficiaries of the Regulatory Improvement Activity are the firms operating in El Salvador (currently more than 25,000) that will experience cost savings as a result of regulatory reforms. The expansion of the El Salvador International Airport under the Partnership Development Activity is expected to decrease delays and travel costs for travelers, while the wind farm project is expected to increase the GoES's ability to attract investment for renewable energy. The beneficiaries of the ESIC are expected to be those firms whose proposals are selected for grant funding, workers who realize net income gains associated with employment as a result of the projects, and third parties who benefit from the public investment.

MCC expects the Human Capital Project to directly benefit students in grades 7-12 in general and technical education, who realize higher incomes as a result of more years of education. In particular, the project is expected to contribute to preventing or postponing the dropout of approximately 176,000 students. Direct beneficiaries of the TVET System Reform Activity are expected to be TVET students who receive higher incomes as a result of receiving skills that are better matched to labor market needs. Additional beneficiaries of the project include students who do not attend a full-time inclusive school but receive increased incomes as a result of improved quality of education that result from the implementation of reforms at the national level. Communities may also experience reductions in crime as a result of the full-time inclusive school model, due to increased permanence of students in school which is expected to reduce their social vulnerability.

The beneficiaries for the Logistical Infrastructure Project are the estimated 171,159 individuals living within five kilometers of either side of the project sites. Because of the nature of the activities as key logistical thoroughfares, benefits in the form of reduced vehicle operating costs and travel time are expected to accrue to individuals and firms that travel along those corridors.