MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform you that the Millennium Challenge Corporation plans to negotiate a Millennium Challenge Compact with the Government of El Salvador.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of El Salvador, please contact me or Jim Mazzarella at (202) 521-3850. This notification is being sent to the Congress on July 29, 2013 and negotiations with El Salvador may be started on or after August 13, 2013.

Sincerely,

/s/
Paul Weinberger
Vice President
Congressional and Public Affairs

Enclosure:
As stated

MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION
July 29, 2013

Pursuant to the section with the heading "Millennium Challenge Corporation" of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2012, as carried forward by the Consolidated and Further Continuing Appropriations Act, 2013, and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification is (1) to advise you that the Millennium Challenge Corporation (MCC) intends to start negotiations with the Government of El Salvador for a Millennium Challenge Compact and (2) to initiate the 15-day consultation period before the start of negotiations.

Attached please find a summary of the objectives and mechanisms to be used for the negotiations of this Compact.

SUPPLEMENTAL INFORMATION
MCC COMPACT DEVELOPMENT WITH EL SALVADOR

Overview

The proposed compact with El Salvador 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

The Government of El Salvador (GoES) completed its first MCC compact – an ambitious $461 million investment focused on the economic development of El Salvador's Northern Zone in order to integrate this region with the rest of the country and to connect to markets in neighboring countries – on September 20, 2012. Through a political transition, the GoES proved itself a reliable and responsible implementation partner in the first compact, and made substantial financial and in-kind contributions to achieve the compact's goals.

The proposed second compact builds on GoES reforms and initiatives and consultations with over 200 businesses to invest in the **institutional capital** of El Salvador and improve the investment climate. Under the current administration, the GoES has passed several laws to facilitate private investment and trade. Most notably, the GoES recently passed a law to allow public-private partnerships (PPPs) in the provision of key public services. The proposed compact would support the successful implementation of this law. To ease the cost of doing business, the proposed compact will also invest in streamlining the regulatory environment. Together with policy reforms and investments in **human capital** to improve education quality and better match skills supplied by the workforce with the demands of the labor market and in **physical capital** to reduce logistics and transportation costs, the proposed compact would improve the climate for private investment.

The proposed compact enjoys broad support from the private sector and across society and the political spectrum. As part of its commitment to the second compact, the GoES proposes to contribute over $88 million. If the compact is approved and ratified by El Salvador's legislative assembly, the reforms and commitments would become law and binding on the next administration.

This compact proposal also reflects MCC's expectation of an evolution in the nature of its relationship with countries eligible to develop subsequent compacts. As noted above, El Salvador demonstrated strong commitment and performance in the implementation of its first compact. As part of its second compact proposal, the GoES proposes a contribution of nearly 32% of MCC's proposed investment of $277 million, far exceeding the 15% MCC requires for second compact, lower middle-income countries. The proposed compact also contains significant policy reforms to the general education and TVET systems, as well as substantial reforms to improve the investment climate and engage the private sector.

The development of this compact has been marked by a high degree of inter-agency coordination to ensure that the proposed investments are complementary to other work that the U.S. government is funding.

In March 2013, MCC committed approximately $3 million under section 609(g) of the Millennium Challenge Act of 2003, as amended, to finance activities necessary to assess the expected impact of the proposed investments, further design activities and develop implementation strategies for the second compact with El Salvador.

Program Overview and Budget

Below is a summary describing the components of the Government of El Salvador's proposed compact. The budget and expected impacts are preliminary based on continuing due diligence and project appraisal and are subject to change following compact negotiations.

PROJECT	Total ($ million)
Human Capital Project	**100.7**
Investment Climate Project	**42.4**
Logistical Infrastructure Project	**109.6**
Monitoring and Evaluation	**4.3**
Program Administration	**20.0**
TOTAL COMPACT BUDGET	**277.0**

In addition, GoES estimates its contribution in cash to the compact will be $88.2 million (32 per cent of MCC's contribution).

Investment Climate Project

Project Rationale and Description

El Salvador's economy suffers from an inefficient institutional and regulatory regime that inhibits private investment and reduces the country's competitiveness in the global economy. In particular, excessive bureaucratic red tape and discretionary application of rules negatively affect the perception of doing business and limit investment. The proposed Investment Climate Project seeks to invest in El Salvador's institutional capital by (i) improving El Salvador's regulatory efficiency and bureaucratic quality, and (ii) providing targeted public services in partnership with the private sector.

The project proposal contains the following two activities:

- **Regulatory Improvement Activity.** This activity focuses on increasing the efficiency and effectiveness of key regulations and institutions to improve the perception of the business environment and bureaucratic quality in El Salvador. The activity will invest in the development of an institutional framework and system to focus on regulatory improvement as well as fund the implementation of a select set of key reforms. The reforms will focus on regulations and processes critical to El Salvador's competitiveness in international markets, such as border crossing and customs procedures, environmental permitting and harmonization of municipal and national regulations.
- **Partnership Development Activity.** Under this activity, GoES seeks to improve its capacity to partner with private enterprise. The Partnership Development Activity will invest in (i) public-private partnerships (PPPs) to outsource the provision of public services to the private sector, and (ii) the El Salvador Investment Challenge (ESIC) – a grants program to more efficiently allocate limited government resources to public goods needed to support private investment in El Salvador. In supporting PPP development, MCC will invest in the capacity of GoES to develop PPPs according to international best practice, starting with two specific projects – the expansion of the El Salvador international airport and the development of a wind farm in the Metapán region. The purpose of ESIC is to enable GoES to identify potential important private investments in goods and services that may be marketed internationally through a competitive call for ideas process, and through the provision of MCC and GoES grant funding to support the public services needed to catalyze the private investments.

The estimated ERR for the proposed Investment Climate Project is 18.56 percent, using a weighted estimate of the calculated ERRs for each activity. The beneficiaries of the Regulatory Improvement Activity are expected to be the 25,139 firms currently registered as operating in El Salvador who will experience cost or time-cost savings as a result of the reforms. There are no direct beneficiaries of the PPP capacity building component of the Partnership Development Activity, but the international airport expansion is expected to decrease wait times, delays and travel costs for travelers, and the wind farm is expected to increase GoES ability to attract investment for renewable energy. Beneficiaries of ESIC are expected to be those firms whose proposals are selected for grant funding, as well as employees or laborers who realize net income gains associated with employment as a result of the projects and third parties who benefit from the public good.

Human Capital Project

Project Rationale and Description

The objective of the proposed Human Capital Project is to improve the quality of education and skills development of Salvadoran students, thus increasing the labor productivity of future workers. Students who are prepared with the requisite basic skills and knowledge at the primary and secondary levels are able to progress to higher-level training in more specific skills demanded by the marketplace in internationally traded goods and services, resulting in higher productivity as these students transition into the labor market.

The project proposal contains the following two activities:

- **General Education Quality Activity.** This activity combines several integrally-connected interventions to improve school quality and allow students to benefit from more time spent learning from teachers with the requisite subject-matter knowledge and pedagogical skills in an institutional and physical environment that is conducive to learning. The activity seeks to strengthen the national education system by reforming the laws, policies, and operations that govern teacher continuous professional development, student assessment, and information systems, and by providing teacher training to enhance knowledge in key subject areas as well as pedagogical training in active learning methods. The activity would also implement a full-time inclusive school model in the coastal zone of El Salvador by extending the school day from part- to full-time, providing instruction using active learning methods in core subjects including English, math, science, and information technology, and focusing on competency development.
- **TVET System Reform Activity.** This activity seeks to further harmonize the skills demanded by the labor market with those supplied by private and public education and training providers. This goal is expected to be accomplished through interventions to strengthen the policies and operations through which the technical/vocational education and training (TVET) system is governed and delineating the roles and coordination processes between the TVET players, particularly the private sector.

The project-level economic rate of return (ERR) for the proposed Human Capital Project, combining all three proposed activities, is estimated at 11.35 per cent. The initial estimated beneficiaries of this project would be 176,917 students in grades 1-12. The benefits of the human capital project are expected to stem from:

- Increased education-years due to reduction in dropout rates in grades 7-12.
- Increased education-years due to greater time-on-task as a result of the full-time inclusive school model system.
- Savings from reduced dropout rates in grades 7-12.
- Increased employment probability for students who achieve high school-level education.

Logistical Infrastructure Project

Project Rationale and Description

The proposed Logistical Infrastructure Project seeks to invest in the **physical capital** of El Salvador to improve critical portions of the logistical corridors between the main border crossing with Honduras at El Amatillo, the Ports of La Union and Acajutla, and the international airport. These activities are expected to reduce the time and cost to transport goods and access services in El Salvador, which should lead to increased investment in the country's production of goods and services.

The project proposal contains the following two activities:

- **Coastal Highway Expansion Activity.** This activity seeks to relieve congestion at the most-trafficked segment of El Salvador's coastal highway (CA-2) that is one of the two most important logistical corridors in the country that connects the country's major logistical nodes, including its two sea ports (La Union and Acajutla) and the international airport. The activity will invest in the rehabilitation and widening, from two to four lanes, of a 27 km section of the highway that connects to the airport. This activity does not pass through any environmentally sensitive areas, but full environmental assessments will be conducted prior to the start of work.

- **Border Crossing Infrastructure Activity.** This activity is designed to relieve the severe freight and passenger traffic congestion at the border crossing into Honduras at El Amatillo. The activity would (i) rehabilitate and improve a 5.74 km road that connects to the border El Amatillo, and (ii) improve and modernize border crossing facilities, including the construction of two stations for customs facilitation.

The estimated ERR for the Logistical Infrastructure Project is 20.31 percent, using a weighted estimate of the calculated ERRs for each activity. The proposed Logistical Infrastructure Project is expected to reduce vehicle operating costs and travel time for between 7,000-12,000 vehicles per day. In addition to reduced travel time and vehicle costs, it is expected that approximately 223,242 individuals who live within 5km of the proposed activities would benefit from the project.