



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 Tanzania.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Tanzania, please contact me or Jim Mazarella at (202) 521-3850. This notification is being sent to the Congress on July 23, 2015, and negotiations with Tanzania may be started on or after August 7, 2015.

Sincerely,

/s/

Paul Weinberger
Vice President
Congressional and Public Affairs

Enclosure:
As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

Pursuant to 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 Tanzania for a Millennium Challenge Compact and (2) to initiate congressional consultation before the start of negotiations.

In addition, we have included supplemental information regarding the objectives and mechanisms to be used for the negotiations of this Compact.

SUPPLEMENTAL INFORMATION PROPOSED MCC COMPACT WITH TANZANIA

Overview

The proposed Tanzania Energy Compact seeks to assist the Government of Tanzania (“GoT”) in addressing one of the major constraints to economic growth: a lack of reliable access to electricity. The compact program seeks to address this complex problem with a comprehensive solution across five, interconnected projects: transformation of the Tanzania Electricity Supply Company (“TANESCO”), reform of the Tanzania energy sector, expansion of the TANESCO distribution system, facilitation of the productive uses of electricity, and transformation of the Zanzibar Electricity Company (“ZECO”).

Background and Context

Tanzania was selected as eligible to develop a compact with MCC in December 2012. It had already completed an economic growth diagnostic, or “constraints analysis,” during the previous year under the Partnership for Growth initiative. This analysis identified the limited availability of reliable electrical power as one of the binding constraints to economic growth in the country.

The power sector in Tanzania is plagued by a cycle of technical and commercial inefficiencies in the public utilities. These problems negatively impact the GoT’s finances, as the government has to directly subsidize the two utilities. Moreover, the country’s power utilities, TANESCO and ZECO, cannot fund routine network maintenance or required network expansions. The GoT has worked with development partners, civil society and the private sector to prepare the Electricity Supply Industry Reform Strategy and Roadmap (ESI Reform Roadmap) to address a variety of challenges in the energy sector. The proposed MCC compact is designed to help the GoT implement critical elements of the ESI Reform Roadmap. The proposed compact will include grants and technical advice in combination with a comprehensive set of conditions and covenants designed to ensure timely GoT actions and safeguard US taxpayer funds. The table below further details those commitments that the government has already fulfilled, those that they are being asked to fulfill before the compact is taken to the MCC Board for consideration and those conditions and covenants envisioned during the compact term.

Over the past two years, MCC and other U.S. government agencies have helped focus the Tanzanian government’s attention on the country’s score on the World Bank’s Control of Corruption indicator and other governance issues. While Tanzania passes this eligibility indicator, it is now in the 53rd percentile (countries must be above the 50th percentile to pass). Beginning in 2014, the Government has taken steps to demonstrate its commitment to working to turn around performance on the Control of Corruption indicator. This has included several actions intended to improve transparency, such as drafting and launching a new 2014-16 Open Government Partnership Action Plan, and working to develop an “open data portal” to increase access to public data. MCC has also expressed concerns this past year regarding Tanzania’s commitment to protect freedom of expression, given controversial recent legislation. Tanzania has worked to address these issues by making it clear that it intends to involve civil society in revising the legislation in question. Additionally, the government passed a Whistleblower Protection Act that local human rights and anti-corruption activists have hailed as important for good governance and transparency in Tanzania. Working with the U.S. Embassy in Tanzania, MCC continues to monitor and assess the GoT’s commitment to good governance.

The possibility of a compact has already spurred the GoT to make important reforms. In November 2014, the GoT and MCC signed an aide memoire detailing a number of critical actions the GoT would undertake during compact development to demonstrate its commitment to increase transparency and accountability in the energy sector. Other reforms are required before compact approval and obligation of funds as detailed here:

Required Compact Conditions		
<i>* Indicates Conditions to be Negotiated</i>		
To be Fulfilled Before Presentation to the MCC Board		Status
Pass the Whistleblower and Witness Protection Bill		Complete
Pass the Petroleum Act, 2015 ¹		Complete
Publish budget documents, as per OGP requirements		Complete
Appoint a Managing Director for ZURA, the Zanzibar Utility Regulatory Authority		Complete
Adopted, through the Ministry of Energy and Minerals, the Natural Gas Utilization Master Plan		Expected by first week of August
Reduced TANESCO's arrears to 75% ² via a payment of approximately \$37 million to TANESCO's creditors		Expected by first week of August
Adopted, through the electricity regulator, EWURA, technology-specific model power purchase agreements		Expected by first week of August
To be Fulfilled Before Entry into Force (Compact Disbursements Begin)		
Adopt, through TANESCO, the revised Power Sector Master Plan		
Adopt, through EWURA, clarified rules for handling unsolicited bids for power generation		
Designate, through TANESCO, TANESCO's grid control center as the independent system operator		
Reduce TANESCO's arrears to 25% ³		
Fund in full the Turnaround Facility for FY 2016-2017 ^{4*}		
Achieve for TANESCO a projected debt coverage ratio of 1.2 for FY 2016-2017*		
Install prepaid meters on those GoT customers of TANESCO whose aggregate consumption in FY15 represents 95% or more of TANESCO's total sales to GoT customers in FY15		
To be Fulfilled During Compact Implementation (Conditions to Compact Tranches)*		
<i>Activity and Condition</i>	<i>Impact</i>	<i>Amount Conditioned</i>
ZECO Private Sector Participation Activity - Government of Zanzibar agrees in writing to pursue a management contract for ZECO	No funding for rehab/upgrades/expansion of ZECO distribution grid	\$40 million
Access 2 nd Tranche – The Independent System Operator and the Independent Market Operator are established and operational	No second phase of intensification activity	\$71 million
Access 3 rd Tranche – The functional separation of an operational generation business unit ⁵	No third phase of intensification activity	\$75 million
TANESCO Transformation - Completion of asset valuation that meets MCC standards; results of asset valuation reflected in audited financial statements	Reduced technical assistance scope; no ERP system	\$42 million
Total		\$228 million

¹ This is equivalent in substance to the Natural Gas Act referenced in the aide memoire further described below.

² Of TANESCO's total arrears as of November 2014.

³ Of TANESCO's total arrears as of November 2014.

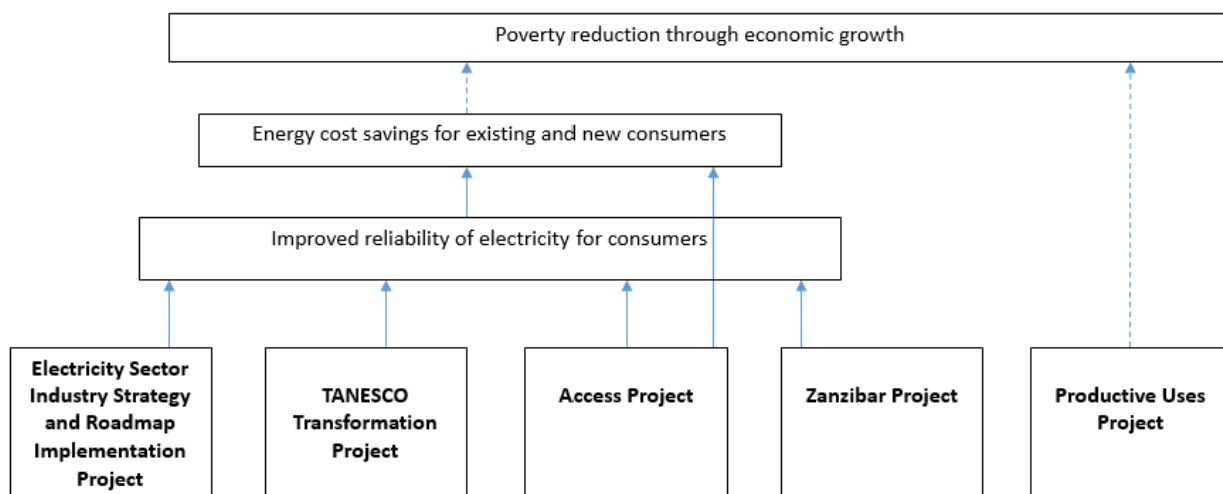
⁴ In addition, GoT shall fund, on an annual basis, the TAF for each subsequent fiscal year during the compact term

⁵ Functional separation includes TANESCO Board approval to establish a separate, fully operational generation business unit with the associated revised senior management reporting structure and ring-fenced accounting structures.

Projects and Budget

Compact logic

PROBLEM: *Tanzanian households and businesses have limited access to adequate and reliable electricity, which constrains economic growth.*



- ***Access to Electricity Project - \$219 million***

This project intends to expand the TANESCO distribution system to approximately 300,000 new customers over the life of the compact. This investment focuses on urban areas of TANESCO's service territory where the increased access is expected to complement the other investments in improving TANESCO's operational and financial results. This program includes financing for customer connections and a campaign to educate and inform potential customers as a means of accelerating and facilitating uptake. The works program will be carried out in three packages to take advantage of pricing and market terms learned from earlier bids. The second and third packages (with expected values of \$71 million and \$75 million, respectively) will be tranching, conditioned upon TANESCO taking measures toward the unbundling of the company prior to issuing the invitations to bid for those packages. The compact will note that if these triggers are not met, the funds will be deobligated rather than reallocated to some other projects in Tanzania.

Economic Analysis

An economic rate of return (ERR) for this project has not yet been finalized. The country's initially proposed project did not produce an ERR acceptable to MCC. The Government of Tanzania has identified an intensification access project that will address the identified binding constraint in a more cost-effective manner. MCC will be able to calculate the ERR within 6 months. MCC will require that the ERR for the project is 10 percent or above before the compact is funded.

- ***TANESCO Transformation Project - \$88.3 million***

This project seeks to prepare TANESCO, Tanzania's vertically-integrated electric utility, for eventual unbundling into a generation company, a transmission company and one or more distribution companies in line with the GoT's ESI Reform Roadmap. The project will also address inefficiencies and redundancies in TANESCO financial, operational, and business processes to improve the creditworthiness of TANESCO as an offtaker. The project – which will focus on the governance, financial management, procurement, data management, customer service, gender integration, environmental and health and safety operations of the company – will provide technical assistance through project management embedded within TANESCO, as well as appropriate IT hardware. Specifically, MCC will help TANESCO's Board of Directors strengthen operational and financial oversight, and enhance the financial and accounting systems to streamline operations as well as allow the utility to track key performance indicators. Finally, the project will improve both TANESCO's environmental, social, health and safety performance and its ability to incorporate gender and social inclusion perspectives, among others, into its planning, customer service, human resources, community outreach, and data collection.

Elements of this project will be conditioned on the GoT completing its ongoing asset valuation and reflecting the results in their audited financial statements. The project funds that will be available once these conditions are met represent approximately \$42 million of investments in technical assistance and IT hardware.

If these conditions are not met, the funds will be deobligated rather than reallocated to other projects in Tanzania. See the section below for economic analysis.

- ***Sector Reform: ESI Reform Strategy and Roadmap Implementation Project – \$39.3 million***

This project will provide support to the GoT as it implements the ESI Reform Roadmap, a program of reforms and institutional improvements to introduce competition in the generation sector and thereby set the stage to increase private investment. Specifically, this project will address three critical areas of planned reforms: governance, market operations, and increase investment in generation capacity. It will also help the GoT better incorporate vital gender, social and environmental considerations into the ESI Reform Roadmap. The GoT and MCC agree that implementing the ESI Reform Roadmap is a critical step to strengthening the environment for private sector investment. When successfully implemented, the reforms will translate into a more stable energy sector that can fuel economic growth.

Both the Sector Reform and TANESCO Turnaround Projects aim to make critical changes, according to the government's plans for a next-generation power market that will support Tanzania's sustained economic growth. The Sector Reform Project is designed to assist the GoT restructure its power market to introduce a competitive wholesale market for power while also creating a level playing field for independent power producers to compete effectively with the state-owned generation company. The TANESCO Transformation Project is designed to assist the GoT in strengthening TANESCO so that it has the financial resources to invest in transmission and distribution infrastructure in Tanzania, as well as to unbundle TANESCO's generation business unit, to increase competition in generation.

To monitor and evaluate these two projects, MCC will track Tanzania's progress toward our shared goals as outlined in the ESI Reform Roadmap. The strategy is to monitor generation added by independent power producers, technical and non-technical losses, and tariffs, among other indicators.

Economic Analysis

Because extensive causal linkages lie between MCC's investment and the desired outcomes, an ERR cannot be calculated for these investments. MCC strives to bring about lasting change in its partner countries by combining support for key infrastructure with support for critical sectoral reforms. This approach is designed to contribute to better functioning government ministries, utilities, and regulatory institutions to enable infrastructure investments to succeed over time and to create better conditions to attract private sector investment in areas that will drive poverty reduction and economic growth.

In the case of some broad sectoral reform projects—such as the ones considered here—the benefits of MCC support are potentially far-reaching and worth pursuing, but additional information and analysis are required to assess the benefits of MCC's specific interventions. MCC will also assess the political economy of these reforms to ensure that our approach will provide the right incentives to achieve these benefits. This assessment will contribute to sharpen the design of these projects.

- ***Productive Uses Project - \$7 million***

Because providing access to a grid connection does not ensure that people will be able to connect, or motivate them to use the electricity efficiently for business activities, this project will help facilitate productive uses of electricity and enhance its usage benefits by using a facility structure to offer grants through a competitive process. Activities, based on applications and ERR analysis, could include grants to i) fund small appliances, such as refrigerators, freezers, sewing machines, stoves/ovens that support micro and small enterprises to increase efficiency and grow their businesses; ii) fund larger scale appliances such as grinders, fruit dryers or other agro-processing equipment that might enable an agricultural co-op or SME to efficiently scale up their operations; or iii) support complementary capacity building and business skills for enterprises which will be using electricity as a catalyst for business growth. Expected economic impacts include accelerated benefits, especially for the rural poor, from electrification and opportunities to leverage funds through partnerships. This project has been jointly conceived in partnership with the U.S. Agency for International Development and will include implementation in geographic areas where Feed the Future is active and as well as co-funding or co-managing of the facility.

Projects that do not meet MCCs ERR hurdle rate will not be funded.

- ***Zanzibar Project – \$58.6 million***

The Zanzibar Project will help improve the transparency and operational effectiveness of the Zanzibar Electricity Company (ZECO) by supporting ZECO in preparing, tendering, and executing a management contract with a private sector utility operator. This private sector participation in the utility, coupled with MCC's investment in a priority infrastructure and rehabilitation investment program, will improve the operational capacity of ZECO, and increase the supply of reliable electricity to the citizens of Zanzibar. Additionally, the compact will invest in a scalable wind or solar project (up to 5MW) to reduce ZECO's dependence on a single supplier, thus improving reliability. The project will also help Zanzibar stand up the utility regulator, the Zanzibar Utility Regulatory Authority (ZURA), and help strengthen environmental, social, health and safety performance in Zanzibar's energy sector. Roughly two-thirds of the funding for this project is contingent on the Revolutionary Government of Zanzibar meeting MCC conditions, including accepting a management contract for ZECO.

Economic Analysis

The precise infrastructure and rehabilitation investments are contingent upon successful initiation of a management contract by ZECO, and will be chosen when the condition to accept a management contract has been accepted. Projects ultimately selected will meet MCC's ERR hurdle rate.

Table 1: Tanzania Compact Budget

Component	Total (in US\$ Millions)*
1. Sector Reform Project	
1.1 Sector Reform Activity	38.8
1.2 ESHS Institutional Support Activity	0.5
Subtotal	39.3
2. TANESCO Transformation Project	
2.2 Financial and Management Operations Activity	20.0
2.3 Information Technology Operations Activity	35.5
2.4 Technical Operations Activity	32.8
Subtotal	88.3
3. Access to Electricity Project	
3.1 Intensification Activity	166.0
3.2 Household Connections Revolving Fund Activity	50.4
3.3 Communications and Community Outreach Activity	1.2
3.4 Surge Staff Activity	1.5
Subtotal	219.1
4. Productive Uses Project	
4.1 Productive Uses Activity	7.0
Subtotal	7.0
5. Zanzibar Project	
5.1 ZURA Standup and Technical Assistance Activity	8.6
5.2 ZECO Private Sector Participation Activity	40.0
5.3 Renewable Energy Activity	10.0
Subtotal	58.6
3. Monitoring and Evaluation	
3.1 Monitoring and Evaluation	10.4
3.2 Technical Assistance	2.0
Subtotal	12.4
4. Program Administration and Oversight	
4.1 Millennium Challenge Account-Tanzania II Program Administration	34.6
4.2 Fiscal and Procurement Agents	12.8
4.3 Audit	0.7
Subtotal	48.1
Total Estimated MCC Contribution	
	472.8
Country Contribution	35.5
Total Program Budget	508.3

*Rounded to the nearest hundred thousand

Update on 2008 Tanzania Compact

MCC signed a five-year compact with Tanzania on February 17, 2008, with a total budget of \$698.1 million. This compact entered into force on September 17, 2008, and closed on September 17, 2013. The compact program sought to increase economic growth and reduce poverty by improving opportunities for value-added industries to flourish, facilitating trade and increasing the supply of critical economic inputs in agriculture and tourism.

The compact supported three categories of strategic investments that were designed to improve the Tanzanian economy including:

1. The Energy Sector Project to increase the availability of reliable electrical power in key regional market centers;
2. The Transport Project to move goods to market centers and facilitate cross-border trade; and
3. The Water Sector Project to reduce the prevalence of water-borne diseases and ensure an adequate long-term supply of potable water.

All compact projects have been completed. Baseline surveys have been conducted for the evaluations of compact projects and activities, but impact evaluation data is not yet available. Evaluation results are expected by 2016 for the Energy Sector Project, but due to delays in the Morogoro works and Lower Ruvu transmission main, results for the Water Sector Project will likely not be available until 2017.

The GoT was an excellent partner in executing the 2008 compact. The GoT committed to cover any cost overruns associated with the compact projects and to complete unfinished work after the compact end date. To fulfill this commitment, the GoT deposited roughly \$132 million into a designated account to cover these costs as well as the salaries for key Millennium Challenge Account-Tanzania (MCA-Tanzania) staff who were retained to oversee the completion of a few outstanding works projects and the defects notification period for the completed works. This staff will be in place until August 2015 to monitor post-compact items and sustainability issues. Some of the staff will also continue to contribute by assisting the compact development team in its further preparation of the Tanzania Energy Compact, as their lessons learned and institutional knowledge have been deemed invaluable resources to the compact development team.

Since the closure of the 2008 compact, the GoT has provided funds to complete the roads construction on Pemba Island and the water investments in Dar es Salaam and Morogoro. Additionally, the GoT funded continued construction on the final segment of the Tunduma-Sumbawanga road to ensure completion and remained diligent in holding contractors accountable for fulfilling the obligations set forth in their contracts with respect to environmental, social, health and safety mitigation. This project is now complete. Travel time to this agriculturally-rich area has been reduced from over 12 hours to approximately four.

To ensure sustainability of the MCC investment, the GoT has committed to:

- (i) making adequate funding available to properly maintain the Tanzanian road network, including the MCC-funded works;
- (ii) sufficiently funding the Morogoro and Dar es Salaam water authorities, to ensure that they can properly operate and maintain the water supply assets in these respective cities; and
- (iii) using the software system acquired under the 2008 compact by TANESCO, the electricity utility, to plan and implement network rehabilitation projects in the future.

To ensure that the 2008 compact work in Tanzania is properly monitored and evaluated, the GoT has appointed the Ministry of Finance, Poverty Eradication Directorate, to liaise with MCC's monitoring and evaluation team to execute the post-compact monitoring and evaluation plans. To date, these plans have been executed as envisioned.

Because the MCA-Tanzania leadership team is still in place, MCC receives periodic updates from the chief officers about the success of the compact projects. MCC continues to stress the importance of sustainability for the 2008 compact to GoT stakeholders in its discussions regarding preparation for a subsequent compact.