



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 Mongolia.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Mongolia, please contact Dan Chaison at (202) 521-3593. This notification is being sent to the Congress on April 5, 2018 and negotiations with Mongolia may be started on or after 15 days of the date of this notification.

Sincerely,

/s/

Karen Sessions
Vice President
Congressional and Public Affairs

Enclosure:

As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

April 5, 2018

Pursuant to section 515 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2006, as carried forward by the Continuing Appropriations Resolution, 2007, sections 699I(b)(3) and 615(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2008, sections 7015(c) and 7057(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2009, the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2015, the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2017, the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2018, and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification serves (1) to advise you that the Millennium Challenge Corporation (“MCC”) intends to start negotiations with the Government of Mongolia for a Millennium Challenge Compact and (2) to initiate Congressional consultation before the start of negotiations.

The following identifies the objectives and mechanisms to be used for the negotiations of this Compact.

OBJECTIVES AND MECHANISMS TO BE USED FOR THE NEGOTIATION OF THE PROPOSED MONGOLIA COMPACT

Overview

The Government of Mongolia (the “Government”) recently finalized the development of its proposal for an MCC compact. The proposed \$350 million Mongolia compact seeks to assist the Government in addressing one of the country’s most binding constraints to economic growth: costly access to water and sanitation in productive sectors and poor communities. The compact would address this constraint through a single project that aims to increase the water supply to the capital city, Ulaanbaatar.

Background and Context

Mongolia is a landlocked country in north central Asia that covers 1.56 million square kilometers, roughly the size of Western Europe. Despite episodes of impressive economic growth within the past decade, Mongolia struggles with young governing institutions, a narrow economic base susceptible to boom-bust cycles, rapid and unplanned urbanization, and an imminent shortage of water in Ulaanbaatar. A sharp economic downturn that started in 2014 has exacerbated these challenges, particularly in Ulaanbaatar, where nearly half of the country’s population and three-quarters of its economic activity are concentrated. Within Ulaanbaatar, 58 percent of citizens reside in informal, unplanned neighborhoods on the outskirts of the city. Residents of these ger areas (so called due to the prevalence of traditional, portable Mongolian homes) have limited access to city services.

According to the World Bank and the country’s National Statistics Office, the percentage of Mongolians living below the poverty line jumped from 21.6 percent in 2014 to 29.6 percent in 2016, reversing nearly a decade of poverty reduction. This increase reflects the collapse in the price of coal and copper, the country’s largest exports, and the impacts of severe winter weather on the livestock that sustain many rural households. Taken together, these forces have changed the country’s socio-economic situation, accelerated internal migration and urbanization, and exposed growing inequalities. In response to the economic downturn, the International Monetary Fund is leading efforts to implement a \$5.5 billion assistance package intended to stabilize the economy and restore confidence through ongoing budget discipline, improved banking practices, and progress on necessary policy and institutional reforms.

MCC’s Board of Directors (the “Board”) selected Mongolia to develop a compact program in December 2014. Working closely with MCC, the Government identified the following four “binding” constraints to economic growth: (i) a weak and unstable macroeconomic environment, (ii) inconsistent laws and policies resulting in an unpredictable business environment, (iii) the health impacts of air pollution in Ulaanbaatar, and (iv) costly access to water and sanitation in productive sectors and poor communities. The Government and MCC agreed to prioritize the water sector, and after working three years to develop a detailed compact program, the Government recently submitted a proposal to expand the sustainable long-term supply of fresh water while simultaneously encouraging wastewater recycling and reuse among large consumers. Through

these actions, the Government's proposal aims to address a troubling mismatch between the supply and demand for water that will cause a water crisis within the next several years, if left unaddressed.

Despite a number of challenges, Mongolia has been a strong partner throughout the compact development process. As a lower middle income country ("LMIC"), Mongolia experienced steady improvement on the control of corruption indicator on MCC's scorecard through 2014, but its raw score on the indicator has essentially stagnated. Mongolia's score experienced a modest decline in fiscal year 2017, but ultimately fell below the median because of a marked improvement in scores among other its LMIC peers. Under the circumstances, the Board endorsed continued work on the compact proposal, but required the Government to pledge a range of concrete anti-corruption actions and periodically report its progress against them throughout 2017. Mongolia once again passed the control of corruption indicator for 2018. Considering this modest performance, MCC will continue to engage the Government on its efforts to combat corruption. Mongolia consistently shows strong performance on a number of other scorecard indicators, including the "hard hurdle" on democratic rights.

To help advance compact development, the Government has established several expert working groups within the Ministry of Environment and Tourism, Ministry of Energy, and the municipality of Ulaanbaatar to provide detailed information and data, review studies and assessments, and assist in key decisions about the direction and shape of the compact program. An additional group of nongovernmental experts also provides guidance on technical matters, and a Cabinet-level working group co-chaired by the Minister of Foreign Affairs and mayor of Ulaanbaatar provides high-level support to the team.

Program Overview and Budget

MCC and the Government have chosen to focus the potential compact program on addressing problems within the water sector in Ulaanbaatar. The city draws its supply of drinking water from wellfields that extract natural groundwater from the alluvial aquifer along the upper reaches of the Tuul River, a braided stream that originates in the Khentii Mountains and flows westward through the city. Only 37 percent of the city's residents receive a continuous supply of water through piped connections, while most of the remainder must periodically purchase water from 634 water supply kiosks located throughout the ger areas. The city's sewer system collects wastewater from residential apartment buildings and a cluster of heavily polluting industries and deposits the mixture at the central wastewater treatment plant, a mechanical plant that was originally built in 1957 and is now severely overloaded. The plant discharges partially treated wastewater to the Tuul River downstream from Ulaanbaatar, creating significant pollution whose effects are felt for 75 km along the river, including potential contamination in the groundwater aquifers nearby. The pollution of aquifers and the continued growth of the city may trigger a water crisis in the next several years.

The Government seeks to address this constraint through a **Water Supply Project**, the goal of which is to increase the supply of bulk water to Ulaanbaatar through two proposed activities:

- A **Downstream Wells Activity** to construct new groundwater wells with attendant transmission lines and reservoirs, along with an advanced water treatment plant; and
- A **Water Sector Sustainability Activity** to support policy reforms, capacity building, and technical assistance to improve the long-term sustainability of the Ulaanbaatar’s water supply.

To ensure the success of the proposed program, the Government is in negotiations to secure external financing to support the construction of a new central wastewater treatment plant, which is critical to the long-term viability of the groundwater aquifers downstream. The Government has estimated that the plant would cost approximately \$300 million.

Table 1 presents an approximate budget for the proposed program based on initial due diligence and appraisal. It sets forth both the MCC funding and the Government’s expected 15 percent country contribution toward the compact objectives. While some details remain under review, MCC expects to invest \$350 million. Costs and expected benefits may change as a result of compact negotiations.

Table 1: Mongolia Compact Budget

Component	Total (million in US\$)
1. Water Supply Project	
1.1 Downstream Wells Activity	\$289.0
1.2 Water Sector Sustainability Activity	\$20.0
Subtotal	\$309.0
2. Monitoring and Evaluation	
2.1 Monitoring and Evaluation	\$9.5
3. Program Administration and Oversight	
3.1 Program Administration and Oversight	\$32.5
Total MCC funding (estimated)	\$350.0
Country Contribution (estimated)	\$52.5
Total Program Budget (estimated)	\$402.5

Note: These numbers reflect best available estimates and remain subject to review and adjustment within the overall MCC budget allocation pending final negotiations. Estimated component amounts may not sum to total due to rounding.

The Government and MCC remain in discussions about a Wastewater Recycling Activity that may be added to the compact program if the Government can mobilize further funding to supplement MCC’s planned \$350 million in funding. The activity would support the construction of a new wastewater recycling plant and extend pipelines to provide high-quality treated wastewater as a substitute to the fresh water consumed in water-intensive industries, thereby reducing industrial water demand and making more fresh water available for household consumption. During compact

negotiations, MCC will make a determination on whether to incorporate this activity into the compact program.

Proposed Project

The objective of the **Water Supply Project** is to meet the projected demand for water in Ulaanbaatar for both households and businesses. The Water Supply Project is comprised of two activities:

- **Downstream Wells Activity**: This proposed activity involves expansion of the city's bulk water supply through the construction of (i) approximately 52 new wells in two downstream wellfields to supply up to 50 million cubic meters of groundwater per year, (ii) associated pipelines, transmission lines, and pumps to convey the water, (iii) an advanced water treatment plant to produce water to drinking standard, and (iv) a storage tank, pumping station and conveyance pipeline to transport finished water into the existing municipal water network of Ulaanbaatar. The aquifers downstream of the city have likely become contaminated from the poor quality surface water in the Tuul River, which has grown increasingly polluted, owing to poorly treated wastewater from the city's central wastewater treatment plant. To mitigate the risk, the activity includes advanced technology for purification of the water to ensure that water supplied to the city is safe and potable. The Downstream Wells Activity is expected to meet the city's growing demand for water for approximately 13 additional years.
- **Water Sector Sustainability Activity**: This activity is designed to enhance the long-term sustainability of water supplies to the capital city through critical policy reforms, technical assistance and capacity building, with a particular emphasis on full cost recovery and improvements in operations and maintenance. The Water Sector Sustainability Activity comprises five sub-activities, which will support (i) utility-wide financial sustainability and cost recovery, (ii) utility cost savings and cost containment for operation in the ger areas, (iii) improved utility operational efficiency, (iv) public communications, stakeholder engagement, and behavior change interventions, and (v) environmental sustainability and natural resource protection. This activity will help to ensure that the benefits of the compact reach all citizens of Ulaanbaatar and are sustained over the long term.

Economic Analysis

The estimated economic rate of return for the Water Supply Project is 10.3 percent over a period of 30 years. The primary objective of the project is to ensure that water supply meets demand in Ulaanbaatar for the immediate future, and primary benefits are the economic impacts of avoiding water shortages in Ulaanbaatar – specifically the benefits to businesses and households from receiving unrestricted access to water. The Water Supply Project will increase bulk water supply for all of Ulaanbaatar. Thus, the beneficiary pool for this project includes the entire population of the capital city. With a population growth rate in Ulaanbaatar of 2.05 percent per year, the number of beneficiaries at the end of the 30-year analytical period is an estimated 2.43 million.

The economic analysis assumes that Ulaanbaatar’s Water Supply and Sewerage Authority (“USUG”) will be able to maintain its assets at a constant level of performance over the next 30 years. This is an extension of 10 years beyond MCC’s normal beneficiary analysis timeline due to the longevity of the proposed wellfield infrastructure. Given that operations and maintenance are essential to the long-term survival of the proposed infrastructure, MCC has included the Water Sector Sustainability Activity to assist USUG in reaching financial sustainability and performing proper maintenance for the life of the assets.

Policy Reform and the Compact

As described above, MCC proposes to support the Government in designing and implementing a number of critical policy and institutional reforms that will enhance the long-term sustainability of the compact. In addition to this, MCC will require certain conditions as part of the compact, the timing and content of which will be negotiated with the Government and included in the compact.

MCC is focused on high-priority reforms that will improve the financial and operational health of USUG. In discussions with the Government, MCC has consistently highlighted the importance of achieving full coverage of the costs of operations, maintenance, and depreciation through significant, sustainable adjustments in tariffs and fees for water and wastewater services. To achieve the aim of full cost recovery, MCC will propose that the Government develop, finalize, and formally adopt a plan that explains how it will achieve full coverage of these costs in order to properly maintain assets and provide sufficient service delivery.

MCC will also look to the Government to uphold policies, laws, and regulations that protect natural resources. Among these, MCC will expect the Government to enforce laws built on the principle that the “polluter pays,” both to discourage pollution and to recoup the full social, environmental, and economic costs of pollution when it occurs. MCC will also expect the Government to develop a plan to ensure that the chemical load of wastewater discharged from industrial sites into the central wastewater treatment plant is reduced. These reforms will not only protect Mongolia’s resources but also support the long-term performance of the city’s water and wastewater infrastructure.

Update and Sustainability of 2007 Mongolia Compact

The Government concluded an earlier compact with MCC on September 17, 2013. That compact encompassed five projects that were designed to increase the productive capacity of both Mongolian individuals and enterprises and unlock opportunities for growth in domestic and regional economies. By the end of that compact, the Government had expended \$268,993,805, or 94 percent, of the compact funds to increase land security, reduce impacts of non-communicable diseases and injuries, provide enhanced vocational training, expand distribution of energy-efficient household products, and construct roads for commercial traffic. The Government and MCC expect more than two million people to benefit over 20 years. MCC continues to assess the performance of the compact’s activities and report on key results and estimated benefits. MCC has concluded independent evaluations of two projects since compact closure, which showed the following:

- The Health Project, which aimed to strengthen the national program for prevention, early diagnosis, and management of noncommunicable diseases, strengthened a culture of quality and thoroughness of planning and analysis in the health system. It also stimulated a culture of efficiency and accountability in the health sector. Beyond the independent evaluation, MCC has learned from stakeholders that the Government is integrating many components of the Health Project into the country's healthcare system, including expanding screenings for hypertension, diabetes, and cervical and breast cancers, and that the Health Project instilled the importance of using preventative measures to combat noncommunicable diseases.
- Under the Energy and Environment Project, participants in the stove subsidy program had 65 percent lower emissions of ambient particulate matter ("PM") 2.5 and 0.9 parts per million lower concentrations of carbon monoxide emissions compared to the baseline. The stove subsidy program reduced ambient PM2.5 concentrations over Ulaanbaatar attributable to heating stoves by an estimated 30% with the largest reductions in highly polluted areas that were more heavily targeted by the program. Health impacts were not directly measured; however, using known dose-response functions (the most advanced methods to estimate health impacts currently available), it is estimated that PM2.5 emissions reductions measured through this study would have resulted in 47 avoided deaths and 1,643 disability-adjusted life years.

MCC continues independent evaluations to measure results achieved as a result of the 2007 Mongolia compact. Depending on the project, it may take some time for these results to manifest and be measurable:

- As part of the Property Rights Project, the Government provided herder groups with long-term private land leases over traditional common grazing areas for the first time, and established an electronic property registry system ("ePRS") in Ulaanbaatar and eight regional offices. These investments are expected to have produced land transaction savings and improved the quality of land administrative services. Following the compact, the Government has continued to strengthen land governance by digitizing all property records and extending the ePRS to the remaining regional offices with support from the World Bank. MCC is conducting a performance evaluation of the Property Rights Project registry strengthening activity and an impact evaluation of the peri-urban land leasing activity, including incorporation of an innovative land quality evaluation to help assess land degradation. Final evaluation reports are expected in 2019.
- The Technical and Vocational Education and Training ("TVET") Project included extensive policy and legal reforms, a new labor market information and career guidance system, and the implementation of a competency-based training approach in the public TVET system. MCC is conducting a rigorous impact evaluation of the Improvement of Learning Environments activity of the TVET Project to measure the impact of vocational equipment upgrades on students' post-graduation employment rates and salary levels. The

results are expected to be released in June 2018. A performance evaluation of the remaining activities in the TVET Project is being designed, with results expected in March 2019.

- The North-South Road Project sought to mitigate Mongolia's inadequate transport infrastructure in a key segment of a critical economic corridor by constructing an all-weather road and connecting Mongolian markets to key trading partners. MCC is planning an evaluation of the North-South Road Project that will measure travel time and vehicle operating cost savings to users of the road and assess maintenance practices to consider how long those savings might last. Results from this evaluation are expected in 2020.