



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform Congress of our intent to provide funding in an amount not to exceed \$350 million under a Millennium Challenge Compact with the Government of Mongolia.

This notification is being sent on June 11, 2018. Obligation of funds may be incurred on or after 15 days from the date of this notification.

In addition to the enclosed notification, which includes the new economic justification requirements per the recently passed MCA Modernization Act, we have included supplemental information describing key elements of the planned compact.

If you or your staff would like to arrange a meeting to discuss the Compact, please contact Jennifer Lackey at (202) 521-7276 or lackeyjc@mcc.gov.

Sincerely,

/s/

Karen Sessions
Vice President
Congressional and Public Affairs

Enclosure:
As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

June 11, 2018

PROGRAM:	Eligible Countries
APPROPRIATIONS CATEGORY:	Fiscal Years 2007, 2008, 2009, 2015, 2017 and 2018 Program Funds
OBLIGATION AMOUNT:	\$350 million

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 Mongolia, through which MCC will grant an amount not to exceed \$350 million to Mongolia under the Millennium Challenge Act of 2003, as amended (the "Act"). To accelerate implementation of the Compact, MCC intends to obligate up to \$28.06 million ("Compact Development Funding") of the overall grant under section 609(g) of the Act, using fiscal year 2017 funds, when the Compact is signed by the parties. Under section 605 of the Act, MCC intends to obligate up to \$321.94 million when the Compact enters into force. This notification is submitted pursuant to section 610(a) of the Act. The Statutory References & Fiscal Year Funding Sources Table shows the statutory references requiring congressional notification for each fiscal year of funding, as well as the related amount of funding under sections 605 and 609(g) of the Act for each fiscal year of funding.

The Compact will support economic growth in Mongolia through assistance in the water sector.

Economic Justification

Analysis conducted by MCC and the Government of Mongolia suggests that inadequate access to water in the capital city, Ulaanbaatar, is among the most binding constraints to economic growth in Mongolia. Ulaanbaatar hosts a large and growing population and a strong economic base of companies engaged in the manufacture of leather goods, the production of cashmere and other wool products, and the processing of meat and food products as well as restaurants, hotels and other services in the tourism industry. These make Ulaanbaatar the economic engine of the country, and many of these businesses, as well as other stakeholders, were consulted during the development of the Compact. Ensuring ample access to water will catalyze private sector investment by allowing these businesses to continue growing, providing jobs and helping to diversify and stabilize the country's overall economy. In addition, the Compact requires the Government of Mongolia to develop and adopt a stakeholder engagement plan for sustaining public consultation and engagement with the private sector.

Given the imminent shortage of water facing Ulaanbaatar, the objective of the Compact through its single project, the Water Supply Project, is to meet the projected demand for water for residential consumers and commercial and industrial users in Ulaanbaatar over the medium term.

The estimated economic rate of return for the Compact is 10.9 percent over a period of 30 years, reflecting the benefits that are expected to accompany a continued, sufficient supply of water.

MCC calculates the ERR based on a detailed cost-benefit analysis. The analytical model measures the capital and future operations and maintenance costs of the project, and compares this to the expected benefits streams to both commercial users and to households. Benefits to households include indirect benefits, for example through improved health outcomes, whereas the principle benefit to business is through available water for productive purposes. Benefits less costs are discounted over the long term to derive a single estimates of the project rate of return.

Because all water consumers and users are expected to receive some of that continued supply of water, the beneficiary pool for the Compact 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 the primary water utility for Ulaanbaatar will be able to maintain its water supply infrastructure at a close to constant level of performance over the next 30 years. It is planned that the Compact activities will assist the utility in reaching financial sustainability and strengthening its operations and maintenance capabilities.

Statutory References & Fiscal Year Funding Sources Table

Statutory Reference Requiring Congressional Notification	Program Funding under Section 605 of the Act (up to)	Compact Development Funding under Section 609(g) of the Act (up to)
Section 515 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2006, as carried forward by the Continuing Appropriations Resolution, 2007	\$31.1 million	
Sections 699I(b)(3) and 615(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2008	\$3.2 million	
Sections 7015(c) and 7057(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2009	\$65.6 million	
Section 7015(c) and the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2015	\$1.1 million	
Section 7015(c) and the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2017	\$66.64 million	\$28.06 million
Section 7015(c) and the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2018	\$154.3 million	
Total	\$321.94 million	\$28.06 million

MONGOLIA COMPACT SUPPLEMENTAL INFORMATION

Overview of MCC Mongolia Compact

MCC's Board of Directors (the "Board") has approved a five-year, \$350 million compact with the Government of Mongolia (the "Government") aimed at reducing poverty through economic growth. The \$350 million Mongolia compact seeks to assist the Government in addressing one of the country's most binding constraints to economic growth: inadequate access to water and sanitation in productive sectors and poor communities. The Compact will 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 two and one-half times the size of Texas. Despite episodes of impressive economic growth since its transition from socialism in 1990, Mongolia continues to struggle with young governing institutions, a narrow economic base susceptible to boom-bust cycles, rapid and unplanned urbanization, and inadequate management of critical natural resources, including water. A collapse in the price of coal and copper, the country's largest exports, led to a sharp economic downturn starting in 2014 that changed the country's socio-economic situation, accelerated internal migration and urbanization, and exposed growing inequalities. 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. In response to the economic downturn, the International Monetary Fund and several international development partners are implementing 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.

The impact of Mongolia's recent economic challenges has been felt most acutely in Ulaanbaatar, where nearly half of the country's population and three-quarters of its economic activity are concentrated. Following decades of rapid urbanization, nearly three-fifths of the city's residents live in sprawling, low-density, peri-urban settlements that lack basic services such as electricity, heat, and water supply. Residents of these *ger* areas (so called due to the prevalence of traditional, portable Mongolian homes) have limited access to city services.

The Board selected Mongolia to develop a compact in December 2014. In the years leading up to its selection, Mongolia performed well on MCC's scorecard criteria, despite graduating from low income country ("LIC") status to the more competitive lower middle income country ("LMIC") status. Mongolia showed steady improvement on the control of corruption indicator through 2014, although its raw score on the indicator has essentially stagnated since that time. 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, where it remains a strong example of democratic values in a difficult region of the world.

Shortly after its selection, the Government worked closely with MCC to identify four binding constraints to economic growth: (i) a weak and unstable macroeconomic environment, (ii) an unpredictable business environment resulting from inconsistent laws and policies, (iii) the health impacts of air pollution in Ulaanbaatar, and (iv) costly access to water and sanitation in productive sectors and poor communities. MCC engaged the Government and its stakeholders in a detailed discussion of the best opportunities to address one or more of the binding constraints. The Government noted that it had already made important strides to control air pollution through the first compact program and was in dialogue with other international development partners to continue support. It also noted that it was taking steps to address business environment issues and did not need additional help. After reviewing initial concepts, MCC concluded that efforts to diversify the economy would require significant time and financial resources but would generate only uncertain returns. In contrast, MCC concluded that efforts to develop new supplies of water for Ulaanbaatar would have a substantial economic impact, given the large population and the economic importance of the city. Through more detailed studies, MCC later confirmed that Ulaanbaatar faces an imminent shortage of water for residential consumption and commercial and industrial uses that may begin to impact quality of life and curtail economic growth as early as 2019. After a careful review and development process, MCC and the Government identified specific investments that utilize new technologies to expand the sustainable supply of potable water and enhance the long-term financial, institutional, and environmental sustainability of the water sector. Through these actions, the Compact will 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.

Mongolia has been a committed partner throughout the identification potential investments and the development of the Compact. The Government established a high-level steering committee chaired by the Minister of Foreign Affairs, an expert working group consisting of the country’s leading water and wastewater experts, and dedicated working groups within the Ministry of Environment and Tourism, the 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. These actions have allowed the Government and MCC to achieve widespread buy-in for the Compact among government authorities, local leaders, and experts.

Compact Overview and Budget

MCC and the Government have chosen to focus the Compact on addressing problems within the water sector in Ulaanbaatar, specifically the imminent shortage of water that threatens Ulaanbaatar’s economy and that could reduce the quality of life of its residents as early as 2019. The city currently draws its annual supply of 77 million cubic meters of drinking water from groundwater aquifers along the upper reaches of the Tuul River, which flows through the city. Studies supported by MCC indicate that any additional extraction of the groundwater upstream

will further diminish river flow and cause portions of the river in this area to run dry, thus making the upper reaches of the river unavailable for future development of water supplies. The groundwater aquifers located along the reaches of the Tuul River downstream from the city must therefore support the city's future needs. However, poorly treated discharge from the city's outdated and overloaded central wastewater treatment plant has contaminated the Tuul River as it flows downstream from the city, thereby introducing potentially harmful contaminants into these downstream aquifers. The pollution of these aquifers at a time of rapid growth in the demand for water only makes the imminent water crisis more acute.

The Government seeks to address the constraint of long-term water supply to Ulaanbaatar through a **Water Supply Project**, the goal of which is to increase the supply of bulk water to Ulaanbaatar through three activities:

- A **Downstream Wells Activity** to construct new groundwater wells with attendant transmission lines and reservoirs in the aquifers downstream from Ulaanbaatar, along with an advanced water treatment plant to remove likely contaminants in the water;
- A **Wastewater Recycling Activity** to construct a new wastewater recycling plant and pipelines to provide high-quality treated wastewater that can be used instead of fresh water by water-intensive power and heating plants and industries, thereby increasing the amount of fresh water available for household consumption; and
- A **Water Sector Sustainability Activity** to support policy reforms, capacity building, and technical assistance, as well as small-scale physical improvements that reduce operating costs at the city's primary water utility to improve the long-term sustainability of Ulaanbaatar's water supply.

Table I presents the Compact budget based on initial due diligence and appraisal. It sets forth both the MCC funding by compact components and the combined MCC and Government's expected country contribution toward the Compact objectives. The Government has pledged to make a country contribution of \$111.76 million in direct investments to the Compact. This country contribution far exceeds MCC's requirement that a country proposing a second compact contribute a minimum of 15 percent of the total value of the Compact. Relative to the size of the Compact, Mongolia's country contribution, at 32 percent, will be the largest investment ever by a partner country toward an MCC compact.

Table I: Mongolia Compact Budget (million in US\$)

MCC Funding by Compact Components	Program Funding under Section 605	Compact Development Funding under Section 609(g)	Total MCC Funding
1. Water Supply Project			
1.1 Downstream Wells Activity	\$223.50	\$16.00	\$239.50
1.2 Wastewater Recycling Activity	\$40.95	\$2.25	\$43.20
1.3 Water Sector Sustainability Activity	\$17.04	\$2.96	\$20.00
Subtotal	\$281.49	\$21.21	\$302.70
2. Monitoring and Evaluation	\$10.33	\$0.03	\$10.36
3. Program Administration and Oversight	\$30.12	\$6.82	\$36.94
MCC Funding	\$321.94	\$28.06	\$350.00

Total Compact Funding	Amount
Total MCC Funding	\$350.00
Government of Mongolia Contribution	\$111.76
Total Compact	\$461.76

In addition, the Government will secure external financing to support the construction of a new central wastewater treatment plant, which will enhance the long-term viability of the groundwater aquifers downstream. The Government has estimated the cost of the new plant to be approximately \$300 million. This funding is not reflected in the country contribution as it is completely separate from the Compact.

Project Summaries

The objective of the **Water Supply Project** is to meet the projected demand for water in Ulaanbaatar for residential consumers and commercial and industrial users over the medium term in ways that are economically and environmentally sustainable. The Water Supply Project is composed of three activities:

- **Downstream Wells Activity:** This 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) storage facilities, 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.

- **Wastewater Recycling Activity:** This activity involves a significant reduction in the demand for fresh water through the construction of (i) a wastewater recycling plant designed to treat a portion of the effluent from the central wastewater treatment plant, (ii) pumping stations and associated pipelines to convey the recycled water to water storage facilities near two large combined heating and power plants, and (iii) internal piping, storage facilities and control systems to facilitate the use of recycled wastewater for certain processes within these combined heating and power plants, the city's largest consumers of water. This activity will substitute recycled water for at least 14 million cubic meters of freshwater that the combined heating and power plants currently consume each year, with an expectation that the volume will increase over time. The wastewater recycling plant will be the first of its kind in Mongolia, helping to pave the path for efficient and responsible management of the scarce water resources of Ulaanbaatar.

MCC estimates that the Downstream Wells Activity and the Wastewater Recycling Activity, when combined, will add 64 million cubic meters to Ulaanbaatar's long-term supply of water, an 83 percent increase in total supply. MCC estimates this volume to be sufficient to meet the city's growing demand for water well beyond the end of the Compact.

- **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 subactivities, 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.

Policy Reform and the Compact

As described above, MCC will 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 and improve the financial and operational health of Ulaanbaatar's primary water utility. In discussions with the Government, MCC has consistently highlighted the importance of achieving full coverage of the costs of operations, maintenance, and depreciation of assets

through significant, sustainable adjustments in tariffs and fees for water and wastewater services. MCC will expect the Government to develop, finalize, and formally adopt a plan to achieve full coverage of these costs in order to properly maintain assets and provide sufficient service delivery. This will be necessary to sustain the performance of water supply wells, ensure the proper functioning of the water purification plant and the wastewater recycling plant, and prevent deterioration in the performance of the new central wastewater treatment plant after its completion.

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 social, environmental, and economic costs of pollution when it occurs. MCC will also expect the Government to develop a plan to reduce the chemical load of wastewater discharged from industrial sites into the city's existing sewer system, which delivers the wastewater to the central wastewater treatment plant. These reforms will not only protect Mongolia's resources but also support the long-term performance of the city's water and wastewater infrastructure.

Finally, through the Wastewater Recycling Activity, MCC will support the development and implementation of a new policy framework and standards for the use of recycled wastewater. Such a framework is needed in order to capture and incorporate lessons learned from the use of new technologies and eventually expand the recycling and reuse of wastewater.

The Compact involves large, complex infrastructure investments in the highly interconnected system for water supply, wastewater collection, and wastewater treatment. MCC will condition its investment on significant, tangible progress on interrelated components, most notably construction of the central wastewater treatment plant. Specifically, MCC will expect the Government to (i) secure financing, (ii) complete acceptable detailed designs and design calculations, (iii) commence construction, and (iv) demonstrate through detailed work plans that the plant can be completed within four years, well before the end of the Compact.

Update and Sustainability of 2007 Mongolia Compact

The Government concluded the first 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 noncommunicable 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 non-communicable 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 percent 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 themselves 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 August 2018. The results of a performance evaluation of the remaining activities in the TVET Project are expected in May 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 annual traffic 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.