



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

This Congressional Notification outlines the Millennium Challenge Corporation's intent to negotiate a Millennium Challenge Compact with the Government of the Republic of Zambia.

If you or your staff would like to arrange a meeting to discuss the proposed program with the Government of the Republic of Zambia, please contact Brian Forni at ForniBJ@mcc.gov.

The attached notification is being transmitted to the Congress on June 27, 2024, and negotiations with Zambia may be started on or after 15 calendar days from the date of this notification.

In addition to the enclosed notification, we have attached supplemental information regarding the planned compact.

Sincerely,

/s/
Aysha House
Vice President
Congressional and Public Affairs

Enclosure as stated

MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION

June 27, 2024

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 commence negotiations with the Government of the Republic of Zambia (“GRZ”) for a Millennium Challenge Compact (“Compact”) and (2) to initiate Congressional consultation before the start of negotiations. The proposed \$458,000,000¹ Compact’s purpose is to assist the GRZ to catalyze inclusive economic growth in the agriculture and agriculture-processing sectors by addressing the binding constraints to economic growth in three key areas: poor roads, limited access to finance for agricultural inputs, and an uncertain agricultural policy environment. The proposed Compact includes four projects: (1) the Roads and Access Project, (2) the Asset Finance Project, (3) the Agriculture Policy Reform and Institutional Strengthening Project, and (4) the American Catalyst Facility for Development Project.

\$302 million of the funding for this Compact has been reprogrammed from MCC’s regional compact with Niger, the termination of which MCC recently notified to Congress on June 11, 2024.

Projected Economic Justification for the Compact

With abundant arable land and water resources, Zambia has enormous agricultural potential, making the country well positioned to meet a growing regional demand for agricultural output as well as processed food products. Expansion of agriculture and agro-processing (AAP) activities spanning crop production as well as a suite of value-adding manufacturing activities, including processing, milling, and packaging, offers a promising inclusive growth path for the country. Further, with over half of Zambia’s labor force—and the majority of the poor—involved in agriculture, the AAP growth path offers the greatest potential for poverty-reducing, sustainable economic growth that aligns with the GRZ’s development priorities.

However, the agricultural sector suffers from low productivity, with average maize yields hovering around two metric tons/hectare, well below the eight tons/hectare achieved by the country’s leading commercial producers. Much of this is owed to low input use, including the lack of irrigation, outdated agricultural practices, and a highly inadequate and climate-vulnerable rural road network. This also constrains the expansion of labor-intensive agro-processors, which source inputs from local farms and comprise Zambia’s second largest segment of the manufacturing industrial sector after mining. Both agriculture and agro-processing are significantly constrained by a lack of access to credit to finance investment in small-scale irrigation and other inputs.

The Zambia compact program aims to address key constraints along the country’s AAP growth path. It will do this through a combination of investments in rural road infrastructure, programs to increase access to credit, and agricultural policy reform initiatives. Investments in these areas will help the GRZ to substantially diversify and grow its economy while reducing poverty. Meanwhile, forecasts of growing domestic and regional demand for increasingly high-value foods promise to sustain growth in the agricultural value chain long after the completion of MCC’s compact program.

¹ Pending budget availability.

The objective of the **Roads and Access Project** is to decrease transportation costs in prioritized agricultural corridors. Poor road conditions force AAP producers to bear high transport costs, high rates of losses in transit, and risks of interrupted market access, ultimately limiting output and depressing private investment. In the prioritized agricultural corridors, the project includes activities to (1) improve road conditions and their resilience, (2) improve access of residents, particularly women, to the road network and markets, and (3) improve road asset management to ensure the sustainability of investments. Through the achievement of the objective, this project supports broader GRZ efforts to increase AAP production and productivity.

The objective of the **Asset Finance Project** is to increase access to finance for investment in energy, irrigation, logistics, processing (EILP) equipment and infrastructure for agriculture value chains for both men and women-owned agricultural small and medium enterprises (Agri-SMEs) and project developers.

At present, the Zambian banking and financial sector has little incentive to make loans to these businesses. Moreover, loans in Zambia are often offered at very short one- to three-year loan terms, with high interest rates and significant collateral requirements that are out of reach for most Agri-SMEs. As such, the project will use MCC grant funding to incentivize financial service and equipment providers to extend more affordable and flexible loan terms to Agri-SMEs to obtain needed EILP equipment. The project will also support the establishment of an impact investment fund that will target early stage agri-enterprises that require long term financing to be viable, including social enterprises that connect smallholder farmers with markets and technical assistance, equipment providers seeking to expand client and geographical coverage, and other agri-related enterprises. This program will offer a more flexible time horizon for returns, which will enable Agri-SMEs to focus on growth and support more innovative or socially impactful ventures that often take more time to mature and demonstrate a profit.

Additionally, there are many larger promising EILP infrastructure projects that support the agriculture value chain in Zambia that are unable to secure financing because of the need for more comprehensive project preparation. The project aims to bridge this gap by using grant funding to support project preparation as well as technical assistance and capacity building for public and private project developers.

The objective of the **Agriculture Policy Reform and Institutional Strengthening Project** is to improve institutional capacity to facilitate private sector production and trade in grains. Through the achievement of this objective, the Compact aims to contribute to creating a private sector-driven AAP market and support broader efforts by the GRZ and other donors to address key policy challenges constraining private sector production and trade in grain markets. It will also strengthen the Ministry of Agriculture's capacity to develop and implement reforms, thereby contributing to the achievement of national food security objectives and encouraging more market-led agricultural sector growth. In particular, the project will address the Food Reserve Agency (FRA)'s practices that crowd out private sector production and marketing of grain. Relatedly, the project will address the FRA's erratic and unpredictable grain trade policies that adversely impact private sector investments and exports by improving the FRA's operational capacity in fulfilling its function of efficiently managing the strategic grain reserves, thereby encouraging greater involvement of the private sector in grain trading and exporting. The project will also build transparency and trust among market players by establishing an independent market observatory that collects timely and

accurate data on stocks and prices and conducts relevant market analyses for the benefit of public sector policy makers and private sector economic actors.

The objective of the **American Catalyst Facility for Development (“ACFD”) Project** is to facilitate U.S. International Development Finance Corporation (“DFC”) investments in Zambia. ACFD grant funding will enable DFC-led projects, that may not otherwise be viable, to reach financial close. While ACFD eligible projects would include projects in any of the identified constraints areas, it also seeks to increase access to affordable finance for private investment in EILP assets that are building blocks for growth in agriculture value chains.

The expected **overall compact economic rate of return (ERR) is 16.35 percent**, which will be updated as additional work is done on the cost benefit analysis, including the incorporation of additional benefit streams and feasibility studies related to the Roads and Access Project. The preliminary estimate of the people who will benefit from the Compact is between 408,000 to 828,000 people.

SUPPLEMENTAL INFORMATION

Overview

The proposed Zambia Compact seeks to assist the Government of the Republic of Zambia (GRZ) in addressing three major constraints to economic growth: (1) poor roads and transport that reduce market access, (2) inadequate private investment in capital inputs needed to boost agricultural production, and (3) an uncertain policy environment for inputs, outputs, and exports. The Compact addresses this through four projects: the *Roads and Access Project*, the *Asset Finance Project*, the *Agriculture Policy Reform and Institutional Strengthening Project*, and the *American Catalyst Facility for Development Project*.

Background and Context

The Republic of Zambia, a landlocked country of twenty million inhabitants and 72 ethnic groups, stretches across southern Africa's central plateau, occupying an area slightly larger than the state of Texas. Categorized as a low-income country with gross domestic product (GDP) per capita at around US \$1,300, Zambia's annual economic growth averaged 3.7 percent over the period 2011 to 2021. This growth has been inconsistent, however, primarily due to Zambia's dependence on exporting copper, a commodity known for its international price volatility. Other vulnerabilities hampering Zambia's growth include reoccurring drought shocks that harm its agriculture and energy sectors. Further, Zambia's extensive public borrowing in the recent past pushed its debt-to-GDP levels above one hundred and twenty (120) percent, overwhelming the country's ability to deliver public services and finance future investments. Meanwhile, the bulk of the country's labor force remains engaged in low-productivity agriculture and informal services, resulting in over half of the population living below the poverty line and income inequality levels among the world's worst. According to the World Bank, agriculture contributes to approximately three (3) percent of Zambia's GDP yet employs over half of its labor force.

Following the election of President Hakainde Hichilema in August 2021, the GRZ prioritized private sector-led growth, more market-friendly policies, and a decentralization of authority and budgets to local authorities. Parallel to this, as part of a larger debt restructuring package with the International Monetary Fund (IMF), the GRZ initiated fiscal reforms that aim to better balance the national budget, reduce public borrowing, and free more credit to the private sector. In a complementary vein, the GRZ also signaled, in its Eighth National Development Plan, a renewed emphasis on economic diversification led by investments in the country's underperforming agriculture and agro-processing sectors. The government's focus on the agriculture and agro-processing economy acknowledges the prevalence of Zambia's poverty among its majority rural population and the sectors' potential for kickstarting inclusive economic growth.

Compact Selection and Ongoing Eligibility

In December 2021, MCC's Board of Directors selected Zambia as eligible to develop a compact in recognition of its consistent passage of the MCC scorecard and the GRZ's commitment and action to sustain investments made under the prior Zambia compact, which closed in 2018. Zambia's peaceful presidential election and transition in 2021 was characterized by observers as a signal of the country's commitment to strengthening economic and democratic governance. In Fiscal Year 2024, Zambia continues to pass the MCC scorecard, passing 17 of 20 indicators overall, including the Control of Corruption and Democratic Rights hard hurdles.

Compact Proposal Overview and Budget

The anticipated budget for the overall program totals \$491,750,000, with Compact funding of \$458,000,000 and the GRZ contribution of at least \$33,750,000 (required minimum of 7.5 percent, excluding ACFD). The following table presents an approximate budget for the proposed Compact based on initial due diligence and appraisal.

Zambia Compact Budget (million in US\$)

| Project/Activity | Total MCC Funding |
|--|--------------------------|
| 1. Roads and Access Project | \$315,000,000 |
| 1.1 Improving Roads Activity | \$285,000,000 |
| 1.2 Improving Access Activity | \$12,000,000 |
| 1.3 Strengthening Zambian Road Management Activity | \$18,000,000 |
| 2. Asset Finance Project | \$45,000,000 |
| 2.1 Agri-SME Asset Financing Activity | \$23,000,000 |
| 2.2 ZAMPPF Activity | \$22,000,000 |
| 3. Agriculture Policy and Institutional Strengthening Project | \$25,000,000 |
| 3.1 MoA Institutional Strengthening Activity | \$13,300,000 |
| 3.2 FRA Institutional Capacity Strengthening Activity | \$7,950,000 |
| 3.3 Establishment and Strengthening of Ancillary Agricultural Market Support Institutions Activity | \$3,750,000 |
| 4. American Catalyst Facility for Development (ACFD) | \$8,000,000 |
| 5. Monitoring and Evaluation | \$3,000,000 |
| 5.1 Monitoring and Evaluation Activity | \$3,000,000 |
| 6. Program Administration and Control | \$62,000,000 |
| 6.1 MCA-Zambia II Program Administration | \$46,000,000 |
| 6.2 Fiscal Agent | \$7,500,000 |
| 6.3 Procurement Agent | \$7,500,000 |
| 6.4 Audit | \$1,000,000 |
| Total MCC Compact Funding | \$458,000,000 |
| Expected Government Contribution | \$33,750,000 |
| Total Program | \$491,750,000 |

Proposed Projects

The four projects and their respective activities to be negotiated are:

The ***Roads and Access Project*** aims to decrease transportation costs in prioritized agriculture corridors by pursuing the following activities and outcomes:

- *Activity 1: Improving Roads Activity* aims to improve road conditions, quality, access, and resilience for selected segments within the identified agricultural corridors through design, construction, expansion, rehabilitation, upgrades, and/or strengthening.
- *Activity 2: Improving Access Activity* aims to improve rural population access to markets and services through physical and non-physical investments potentially including trail bridges, pedestrian amenities paired with the application of the Gender Action Learning System in rural communities.
- *Activity 3: Strengthening Zambian Road Management Activity* aims to provide technical assistance, capacity building, and legal and institutional reforms to road sector actors to improve road asset management.

The ***Asset Finance Project*** aims to increase access to finance for investment in EILP equipment and infrastructure for agriculture value chains for both men and women-owned Agri-SMEs and project developers by pursuing the following activities and outcomes:

- *Activity 1: The Agri-SME Asset Financing Activity* aims to increase access to finance for Agri-SMEs by facilitating the provision of more affordable loan terms and extending patient, grant capital to incentivize investors and minimize risk.
- *Activity 2: The Zambia Project Preparation Facility Activity* aims to increase the number and value of larger EILP infrastructure projects that support agriculture value chains to reach financial close by providing project preparation support and technical assistance and capacity building for public and private project developers.

The ***Agriculture Policy Reform and Institutional Strengthening Project*** aims to improve institutional capacity to facilitate private sector production and trade in grains by pursuing the following activities and outcomes:

- *Activity 1: The Ministry of Agriculture Institutional Strengthening Activity* aims to strengthen the Ministry of Agriculture's capacity to develop and implement reforms.
- *Activity 2: The Food Reserve Agency (FRA) Institutional Strengthening Activity* aims to improve the FRA's operational capacity in fulfilling its main functions of efficiently managing the strategic grain reserves, encouraging greater involvement of the private sector in grain trading, making timely payment for purchases, and providing appropriate price stabilization functions.

- *Activity 3: The Ancillary Agricultural Market Support Institutional Strengthening Activity* aims to build transparency and trust among market players by establishing an independent market observatory that collects timely and accurate data on stocks and prices and conducts relevant market analyses for the benefit of public sector policy makers and private sector economic actors, enhancing crop forecasting, and supporting the commodity exchange.

The *American Catalyst Facility for Development (ACFD) Project* aims to facilitate DFC investments in Zambia. This will enable DFC-led projects in the identified compact constraint areas to reach financial close and catalyze private investment in Zambia.

Policy Reform and the Compact

MCC and the Government of Zambia jointly identified the following key policy reform areas to support the sustainability of the proposed Compact, the timing and content of which will be negotiated with the GRZ and will be included in the Compact or related agreements.

Key policy reforms of the *Roads and Access Project* include technical assistance, capacity building, and policy and institutional reforms to improve road asset management through improving the planning, prioritization, and execution of road maintenance. MCC has a valuable opportunity to improve road asset management for the sustainability of our road investments and other roads across Zambia. Reforms and technical assistance targeting national and local road sector actors will improve road asset management through institutional capacity building and improved budgeting and planning.

Key policy reforms of the *Agriculture Policy Reform and Institutional Strengthening Project* include three inter-related agricultural laws that are inconsistent and inadvertently hinder private sector operations in the agricultural market. The GRZ has prioritized consistent and evidence-based trade policy and laws, a reduction in the Food Reserve Agency's market interference in grain markets, and decentralization of grain export permits in order to enhance the private sector investment in the sector, create jobs, increase incomes, and ultimately lead to sustainable sector growth. Addressing these concerns hinges on three interrelated policies namely (1) the Food Reserve Act; (2) the Agricultural Credits Act; and (3) the draft Agricultural Marketing Bill. If reformed in harmony, these laws aim to help enhance private sector investments in agricultural marketing and trade and ultimately sector growth.

Update and Sustainability of the Zambia Water and Sanitation Compact (2013-2018)

The 2013 Zambia Compact invested \$332 million to support major infrastructure improvements and institutional strengthening of the Lusaka City Council (LCC), the entity responsible for municipal public health and drainage, and the Lusaka Water and Sewerage Company (LWSC), the entity responsible for the city's water supply and sanitation services. The Infrastructure Activity, with final disbursements of \$272.7 million, invested in infrastructure development and the rehabilitation of Lusaka's water supply network, expanded its water-borne sewage network, and improved its storm-water drainage. The compact's \$19.8 million Institutional Strengthening Activity was designed to strengthen the ability of the municipal government and the water utility to provide quality water-related services and maintain the compact's infrastructure investment. The compact also included a \$10 million innovation grant program designed to support innovative solutions to improving access to drinking water, sanitation and hygiene, household water and sanitation financing, and garbage management services for poor Lusaka communities. A total of

fourteen (14) activities were financed, including the collection of recyclable plastics, locally made feminine hygiene products, a loan program to allow households to connect to the sanitation network, a solar powered water pump, and the crafting of fence posts, tables, chairs, and other items with recycled materials. Following the compact's closure in 2018, the GRZ provided \$45.5 million to complete the remaining infrastructure works. As a result of the compact's activities, in the shanty town of Mtendere, where the remaining works were completed in 2024, 24,000 people now benefit from access to clean drinking water with household connections and 13,700 people benefit from access to sanitation via the new sewer network.

Update on the Zambia Threshold Program (2006-2009)

Zambia's Threshold Program had three projects designed to support the program's objective to combat corruption in key government institutions and reduce barriers to increased trade and investment. Significant program results include the establishment of one-stop shops that automated procedures for business registration and tax payment, and reduced processing times for customs operations.