



MILLENNIUM
CHALLENGE
CORPORATION

REDUCING POVERTY THROUGH GROWTH

FRANCES C. McNAUGHT
VICE PRESIDENT, CONGRESSIONAL AND PUBLIC AFFAIRS

CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform you of the signing of a Millennium Challenge Compact with the Kingdom of Lesotho in accordance with Section 610(b)(1) of the Millennium Challenge Act of 2003. In addition to the enclosed notification, we have included a detailed summary of the Compact along with a copy of the text of the Compact signed July 23, 2007.

The attached notification is being sent to the Congress on July 25, 2007.

Sincerely,

Frances C. McNaught
Vice President
Congressional and Public Affairs

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

July 25, 2007

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|-------------------------------|-----------------------|
| PROGRAM: | Eligible Countries |
| APPROPRATION CATEGORY: | FY 2007 Program Funds |
| OBLIGATION AMOUNT: | US\$362,551,000 |

In accordance with Section 610(b)(1) of the Millennium Challenge Act of 2003 (the “Act”, Pub. L. 108-199, Division D), this is to advise that the Millennium Challenge Corporation (MCC) has entered into a Compact with the Government of Lesotho (GOL) pursuant to Section 609 of the Act, through which MCC will grant up to US\$362,551,000 in FY 2007 Millennium Challenge Account (“MCA”) funds. Of this amount, MCC plans to obligate pursuant to the authority of Section 605 of the Act up to US\$346,882,584 at the time the Compact enters into force. The Compact will enter into force pursuant to Section 7.3 of the Compact upon satisfaction of certain conditions set forth in Section 7.2 of the Compact. These funds will be disbursed on a periodic basis over the course of the Compact’s term upon satisfaction or waiver of relevant conditions precedent.

In order to accelerate implementation of the Compact, MCC has obligated the remaining US\$15,668,416 of the total amount (“Compact Implementation Funding”) at the time of the signing of the Compact, pursuant to the authority of Section 609(g) of the Act.

The United States, acting through MCC, and the GOL executed the Compact on July 23, 2007.

A detailed summary of the Compact follows along with a copy of the text of the Compact.

EXECUTIVE SUMMARY

A. INTRODUCTION

Lesotho is strategically located within the rapidly growing Southern African Development Community which will become a common market in 2008. It could benefit greatly from the expected economic upsurge in the region led by the private sector, but it will miss this opportunity if it is unable to unlock the potential of its two greatest resources – its water and its people. Without immediate and sustainable interventions to harness its abundant water resources and to improve the health of the productive workforce, Lesotho has limited prospects of achieving economic growth. Another

critical element to Lesotho’s future economic growth is a dynamic private sector. In recent years, the Government of Lesotho (“*GoL*”) has embarked on a major reform program developed jointly with the World Bank and other bilateral donors, to remove legal and regulatory impediments to private sector growth, improve access to credit and increase the participation of women in the economy.

B. PROGRAM

1. Goal and Objectives

The \$362.6 million Compact focuses on water, health and private sector development (*the “Program”*), as summarized in the table below. The Program is focused on improving the provision of water supplies for industrial and domestic use, improving health outcomes and productivity through strengthening the health infrastructure, and removing barriers to foreign and local private sector investment. The Compact is designed to have a high economic growth impact, and its potential impact on poverty reduction is significant and widespread due to its broad geographical scope.

| Multi-Year Financial Plan (By Project) | Totals Including Contingencies (in millions USD) | | | | | | |
|--|--|--------|--------|---------|--------|--------|---------|
| | CIF | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Total |
| 1. Water Sector Project | 4.913 | 21.092 | 24.233 | 49.074 | 47.878 | 16.838 | 164.028 |
| 2. Health Sector Project | 4.436 | 17.961 | 27.927 | 37.616 | 24.846 | 9.612 | 122.398 |
| 3. Private Sector Development Project | 0.710 | 7.142 | 10.906 | 8.525 | 5.47 | 3.352 | 36.105 |
| 4. Monitoring & Evaluation | 0.5 | 2.605 | 0.684 | 0.755 | 0.664 | 2.6 | 7.808 |
| 5. Program Management and Oversight | 5.109 | 4.173 | 5.395 | 6.196 | 6.926 | 4.413 | 32.212 |
| TOTAL MCC CONTRIBUTION | 15.668 | 52.973 | 69.145 | 102.166 | 85.784 | 36.815 | 362.551 |

C. PROGRAM DESCRIPTION

1. Water Sector Project (\$164 million)

The Water Sector Project is aimed at improving water supply for industrial and domestic needs. With respect to the industrial sector, the Project will provide infrastructure to deliver water to garment and textile operations. Domestic users in selected urban and rural areas will benefit from water system upgrades and expansion to achieve better

sanitation and a reliable supply of water. Finally, the Project is designed to enhance rural livelihoods through improved watershed management.

The Water Sector Project activities include: (a) construction of a bulk water conveyance system and establishment of a program management unit for the Metolong Dam construction activity; (b) extension and rehabilitation of the urban and peri-urban water network; (c) provision of improved sanitation services to rural households through construction of ventilated improved pit latrines and water systems; and (d) restoration of degraded wetlands at three areas in the highland pastures and preparation of a strategic environmental assessment to support development of a national watershed management and wetlands conservation plan.

2. Health Sector Project (\$122 million)

Approximately 24 percent of adults ages 15-49 in Lesotho are Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (“*HIV/AIDS*”) positive, the third highest prevalence rate in the world. The Health Sector Project is designed to mitigate the negative economic impacts of poor maternal health, HIV/AIDS, tuberculosis (“*TB*”) and other diseases by substantially strengthening the country’s health care infrastructure. MCC funding will support the GoL’s efforts to significantly increase access to life-extending anti-retroviral therapy (“*ART*”) by providing a sustainable platform to deliver this and other essential health services throughout the country. This has the potential to result in a measurable extension of productive life-years for people living with HIV/AIDS, TB and other debilitating diseases.

A major issue in Lesotho, as in the rest of southern Africa, is the crisis in human health resources. The country has difficulty retaining nurses and clinicians due to opportunities outside the country and poor working conditions in Lesotho. Extensive studies have been conducted on improving the retention of health care workers. Top concerns are salary levels, physical working conditions and supervision and career management structures. Together with the GoL, the President’s Emergency Plan for AIDS Relief (“*PEPFAR*”), and other donor efforts, the Health Sector Project is designed to address these issues. Currently the GoL is proposing salary reforms and PEPFAR is providing assistance to improve training curricula and programs, reduce red tape in hiring new graduates, and rationalize Ministry of Health and Social Welfare (“*MoHSW*”) staff positions. The Project is designed to improve health sector infrastructure, including residences for rural health staff, improve supervision and management of staff, increase the number of nurses and allied health professionals trained, and provide opportunities for staff to build skills and competencies through continuing education. These efforts are designed to increase production and retention of health workers for delivery of essential health services.

The Health Sector Project activities include: (a) renovation of up to 150 health centers in order to establish a national stock of health centers that achieve a common standard; (b) establishment of ART clinics in and improved management of up to 14 hospital out-patient departments (“*OPDs*”); (c) construction and equipping of a new central laboratory and training laboratory staff; (d) construction of a dedicated, central facility

for collecting and processing blood and provision of mobile blood collection and storage equipment; (e) an increase in the number of dormitories and staff residences at Lesotho's National Health Training College ("*NHTC*"); (f) strengthened health systems through increased capacity for pre-service and in-service nurse training and improved district-level public human health care resources management; and (g) improved occupational health and safety and medical waste management practices.

3. Private Sector Development ("*PSD*") Project (\$36 million)

The PSD Project is designed to increase private sector economic activity in Lesotho by improving access to credit, reducing transaction costs and increasing the participation of women in the economy. The activities within the PSD Project represent an essential component of the GoL's major policy reform program and are designed to contribute to the broader efforts to attract foreign investment and stimulate growth of Basotho-owned companies.

The PSD Project activities include: (a) reform of the civil legal system through the development of the Commercial Court, including creation of case management systems for courts, and promotion of alternative dispute resolution; (b) support for the production and issuance costs of national identification cards as well as establishment of the necessary legal and regulatory reforms for data privacy and establishment and operations of a cross-border credit bureau; (c) support for implementation of a new payments and settlement system in Lesotho; (d) technical assistance to the GoL in the development of land policy in Lesotho, and funding for the implementation of a systematic land regularization program for urban and peri-urban areas and development of a new land administration authority; and (e) implementation of a training and public awareness program dedicated to implementing gender equality in economic rights and building of local capacity to continue advocacy.

D. IMPACTS

The Program, if successfully implemented, could nearly double GDP growth by the end of the Compact implementation period (using a baseline of 2.6 percent). The acceleration of GDP growth is expected to continue beyond Compact completion, propelling growth towards seven percent per annum within five years after Compact completion. This acceleration is required to reduce poverty significantly in line with the objectives of the GoL's Poverty Reduction Strategy Papers ("*PRSP*").

The **Water Sector Project** is expected to benefit urban and rural communities through the each of the four activities: (1) The Metolong Dam – Bulk Water Conveyance System activity is expected to preserve existing industrial production and 28,000 jobs and create an additional 6,000 jobs by the end of the Compact; (2) The Urban and Peri-Urban Water Network activity has the potential to benefit approximately 304,000 people or 50,700 households by Compact end; (3) The Rural Water Supply and Sanitation activity

has the potential to directly benefit approximately 150,000 people or 25,000 households; and (4) The Wetlands Restoration and Conservation activity has the potential to improve rangeland productivity and benefit rural livelihoods for an estimated 55,000 people who live within a 16 kilometer radius of the three target wetland sites.

The **Health Sector Project** is designed to directly improve delivery of health care services to the entire population. The health center activity is designed to improve service quality and availability for health center clients, including: most of the 90 percent of pregnant women who seek prenatal care; the more than 90 percent of infants and young children who are immunized against childhood infectious diseases; the approximately 9,000 TB patients treated at the health center level each year; and the 34,000 persons expected to have ART services follow up at the health center during the life of the Project. The ART clinic activity is designed to reduce waiting times and TB co-infection of clients seeking care at an OPD, particularly the predicted additional 17,000 new clients seeking ART services during the Compact, the 80 percent of those clients expected to be co-infected with TB, and the clients of other OPD services in these 14 hospitals. This activity is designed to complete national coverage of ART services at the hospital level. The central laboratory and blood transfusion activities are designed to benefit all Basotho by expanding the capacity of the MoHSW to conduct needed laboratory tests and assuring access to safe blood. The NHTC activity is designed to expand the number of graduates in the health field, filling some of the numerous vacancies in rural areas for community nurses and allied health professionals. As a result, more than 1.3 million individuals in the rural areas are more likely to have an adequate level of service provision at the local health center level. The health systems strengthening and medical waste management activities are designed to impact the quality and level of services provided, particularly at the health center level and improve environmental health and safety conditions throughout the health sector. All activities focus on improving physical working conditions and safety for health workers and on human resources management.

The **Private Sector Development Project** has the potential to benefit approximately 2,000 persons and companies operating in the formal sector through more efficient commercial court procedures. Through the Land Administration Reform activity, potentially up to 55,000 urban households may benefit from having formally recognized titles. The National ID activity has the potential to directly benefit the entire national population by providing an identification card and/or unique identification number to every citizen within the country, improving the availability of credit and other financial services to a wider cross-section of the population. Finally, the Payments and Settlements system has the potential to directly benefit more than 86,000 government pensioners and more than 98,000 employed outside Lesotho by lowering the costs of receiving and sending money.

E. PROGRAM MANAGEMENT

1. Governance Structure

The GoL will establish an autonomous body within the Ministry of Finance and Development Planning known as MCA-Lesotho that will serve as the accountable entity responsible for the implementation of the Program. The MCA-Lesotho board of directors will be made up of government officials representing each of the GoL ministries associated with the Program as well as private sector and civil society members representing constituencies impacted by the Program. This board will have independent decision making authority and will be the final authority with respect to implementation of the Compact. It will provide oversight and be responsible for the success or failure of the Program.

A management unit will support the board of directors in implementing the Program and will be responsible for the day-to-day management and operations of MCA-Lesotho. A stakeholders committee will inform the various constituent groups about Program implementation, provide advice and input to MCA-Lesotho concerning the Program, and select the private sector members of the board of directors.

External procurement and fiscal agents will be used during Compact implementation. A procurement process is currently underway with a target date of August 2007 to sign contracts for these services.

2. Implementation Arrangements

Line ministries, project implementation units and the Central Bank of Lesotho will serve as implementing entities (“*IEs*”) and service providers for the various projects related to the Compact under contractual relationships with MCA-Lesotho. IEs will be responsible for developing the operational requirements for the Projects and performance monitoring of contractors. Teams will be located within the IEs to ensure institutional strengthening and close collaboration and communication. To help ensure Program success, the Compact has budgeted nearly \$75 million for technical assistance, capacity building, and institutional strengthening. In addition, competitively selected external service providers will perform the Procurement and Fiscal Agent functions. MCA-Lesotho will remain ultimately responsible for the successful implementation of the Program.

F. OTHER HIGHLIGHTS

1. Transformational Change

The Program has the potential for significant transformational change to help unlock the economic potential of the country by providing additional water supplies for industrial and domestic use, improving health outcomes and productivity and by removing barriers to foreign and domestic investment. Overall the Program is expected to impact a broad cross-section of the country through its various activities. In addition, the Compact is designed to have a substantive impact on extending full economic rights to women in Lesotho.

2. Consultative Process

The Program builds upon the GoL's PRSP and the Lesotho Vision 2020. The consultative processes associated with these two initiatives identified the following as top priorities for poverty reduction and economic growth: (a) private sector development; (b) provision of infrastructure; (c) natural resource management; and (d) improved access to health care.

Shortly after Lesotho was selected as an MCC-eligible country in 2004, the GoL established a consultative proposal development process that included the private sector, non-governmental organizations ("NGOs") and civil society organizations. Recognizing that consultations are ongoing and must be meaningful, timely and participatory, the MCA-Lesotho Core Team within the Ministry of Finance and Development Planning was proactive in developing an outreach and consultative process strategy in early 2007 to plan for consultations and outreach activities beyond Compact signing and into implementation.

3. Government Commitment and Effectiveness

The 2006 enactment of the Legal Capacity of Married Persons Act was a strong signal of the GoL's commitment to remove barriers to married women's full participation in the economy, thereby enhancing the Program's prospects of successful implementation and sustainability. This significant commitment to gender equality was recently acknowledged by resolutions adopted by both the U.S. Senate and the U.S. House of Representatives. Prior to first disbursement of Compact funds, the GoL will submit to its Parliament legal reforms designed to assure that economic rights achieved in the Legal Capacity of Married Persons Act are not contradicted in other laws.

The GoL has agreed with the World Bank on a comprehensive water sector reform program. In the rural water and sanitation sub-sectors, the GoL – consistent with its policy on decentralization – is divesting financial management, project planning, supervisory services and asset ownership to locally elected water committees.

In 2000, the GoL embarked on a ten year plan to improve health service delivery. The GoL has successfully piloted decentralized health services in three districts and is expanding decentralized management to the remaining seven districts. New financial management and procurement systems have been put in place, and a new human resources system is being developed. The Health Sector Project is designed to complement other donor funded activities. Despite the HIV/AIDS epidemic, Lesotho has met both MCC eligibility indicators on immunization and health expenditure which signals the GoL's commitment to good performance in the health sector.

The GoL, as chair of the Southern Africa Development Community, has committed to regional integration of financial systems. They also have initiated the process of implementing policy reforms to improve the business and investment climate with the support of donors such as the World Bank. In order to realize the maximum economic benefits for the PSD Project activities, the GoL must continue this policy reform

momentum and harmonize its legislation with other Common Monetary Area countries, especially South Africa.

G. SUSTAINABILITY

The Program is designed to enhance the sustainability of its benefits by: (a) supporting policy reforms in relevant sectors; (b) ensuring adequate funding will be allocated to fully cover additional recurrent costs; (c) requiring adherence to environmental and social standards; (d) building capacity within the GoL to facilitate implementation of the Program and to develop long-term management capabilities of GoL institutions; (e) assuring improved maintenance programs to maintain the economic life of assets; and (f) promoting participation of a large cross section of Basotho, especially women and the poor.

1. Water Sector

The sustainability of the Water Sector Project activities depends on the GoL's pace of implementation of sector policy reforms and its commitment to ensure that tariff levels provide for cost recovery of operations and maintenance costs. Disbursements of Compact funding will be tied to agreed progress on implementing water sector reforms.

2. Health Sector

The sustainability of health services is a critical issue, particularly given the increase of donor-supported provision of ART. In partnership with donors, the GoL is developing a national health financing strategy to identify the costs of the essential health services package, including ART, and gaps and potential sources of funds. This strategy will be jointly monitored by MCC and other health donors.

3. Private Sector Development

The sustainability of several PSD Project activities is expected to be enhanced because they will be carried out with the assistance of established private sector entities with a successful track record in the Southern African region. Compact funding also is designed to help establish sustainable improvements in land administration through an active capacity building, training, and public education effort.

4. Environmental and Social Impacts

The assessment, management, and monitoring of potential environmental and social impacts is an integral part of the Compact. The Compact will fund several measures to: (a) mitigate the adverse effects of infrastructure construction or rehabilitation; (b) promote natural resource management and environmental conservation consistent with the priorities of the GoL's PRSP; (c) assure women's participation in the economy and as beneficiaries in the Compact; and (d) integrate HIV/AIDS awareness programs into all construction contracts. The Compact will also support measures to strengthen the

regulatory framework and build institutional capacity required to improve occupational health and safety and waste management practices in the health sector.

The Metolong Dam activity is a Category A project under MCC's Environmental Guidelines due primarily to the potential environmental and social risks associated with the project, which include loss of communal resources, loss of traditional access routes across the river, inundation of cultural resources and alteration of downstream surface water hydrology. The entities funding the dam have agreed that the entire project, including advanced infrastructure, the dam and reservoir and downstream bulk water conveyance system, will be designed and constructed according to common standards that meet MCC's Environmental Guidelines, the MCC Gender Policy, GoL law, and World Bank Operational Policy 4.12 on Involuntary Resettlement. Compact funding for the bulk water conveyance system will be conditioned on strict adherence with the larger project's environmental management plan ("EMP") and resettlement action plan ("RAP"), completed earlier this year with World Bank funding. The urban, peri-urban and rural water activities are considered Category B and Category C projects under MCC's Environmental Guidelines and do not pose significant adverse environmental and social impacts. Standard EMPs will be developed for each activity to assure compliance with MCC's Environmental Guidelines and GoL laws. The wetlands restoration and conservation activity is expected to result in mostly positive environmental and socioeconomic impacts by rehabilitating three severely degraded wetland areas which support livestock grazing and other rural livelihood benefits.

The Health Sector Project consists of both Category A and Category B projects under MCC's Environmental Guidelines due to greenfield construction and concerns regarding current medical waste management practices in Lesotho. To make long-term improvements to the current situation and assure that MCC-funded facilities comply with MCC's Environmental Guidelines, Compact funds will be used to update Lesotho's 2005 National Health Care Waste Management Plan, develop medical waste management regulations and standards, prepare a financial plan and provide technical assistance to the relevant GoL agencies. Additionally, all proposed health infrastructure activities must comply with MCC's Environmental Guidelines and applicable GoL environmental permitting requirements.

The PSD Project, a Category C project, is not likely to have adverse environmental or social impacts. The MCA-Lesotho social-gender specialist will work to ensure that social safeguards are integrated into project design, implementation and monitoring to ensure that the activities do not, unnecessarily or unlawfully, infringe upon rights or privacy.

H. DONOR COORDINATION

The design and technical aspects of many of the Compact Program activities have benefited significantly from the experiences of other donors working in Lesotho. The MCA-Lesotho Core Team has engaged the donor community frequently in all phases of the consultative process and has coordinated with donors to refine Compact activities,

collaborate on shared objectives to prevent duplication of efforts, and ensure complementary activities throughout Compact implementation.

In the various Health Sector Project activities, including those associated with HIV/AIDS, MCC has maintained regular communications and participated in joint donor reviews. These donors include: PEPFAR; Irish Aid; World Bank; African Development Bank; United Nations agencies; and the Global Fund for AIDS, Tuberculosis and Malaria. These and other donors provided design support to the MoHSW and assisted MCC in the due diligence process. The Compact's Health Sector Project is designed to support the GoL's reform efforts and fits within the combined donor strategy for the health sector. In particular, the MCC Health Sector Project and planned PEPFAR activities are mutually reinforcing. As MCC has moved forward with the proposed Health Sector Project, PEPFAR has provided encouragement and support at central and country level. In-country PEPFAR staff has grown from one person in 2006 to a staff of seven professionals by end of 2007, with an expected concomitant increase in resources. Together, MCC and PEPFAR inputs are expected to result in a major increase in the quality and quantity of ART services and in the production and retention of human resources for health.

The Metolong Dam activity is being developed in coordination with several donors, including the OPEC Fund for International Development, the Kuwait Fund for Arab Economic Development, the Arab Bank for Economic Development in Africa and the Saudi Fund for Development. The European Union also has a sustained presence in Lesotho's water sector and is currently funding detailed designs for components of the Metolong Dam bulk water conveyance system, as well as components of the larger lowlands water supply system. Irish Aid is also a significant donor in the water sector.

MCC has also been actively collaborating with other donors on the PSD Project. These donors include: the World Bank with respect to the national identification card; the United Kingdom's Department for International Development on matters concerning civil legal reform and land administration reform; the German development agency Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) on land administration reform; and USAID through its Women's Legal Rights Initiative project.