



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 the Republic of Malawi.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with Malawi, please contact Ellona Fritschie (for the Senate) or Erin Kolodjeski (for the House of Representatives) at (202) 521-3850. This notification is being sent to the Congress on October 21, 2010, and negotiations may be started on or after November 5, 2010.

Sincerely,

A handwritten signature in blue ink, appearing to read "James Mazarella", with a long horizontal flourish extending to the right.

James Mazarella
Vice President (Acting)
Congressional and Public Affairs

Enclosure: As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

October 21, 2010

Pursuant to the section with the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010 (Pub. L. 111-117, Division F), and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification is (1) to advise you that the Millennium Challenge Corporation intends to start negotiations with the Government of the Republic of Malawi for a Millennium Challenge Compact and (2) to initiate the 15-day consultation period before the start of negotiations.

A statement of the objectives and mechanisms to be used for the negotiations of the Compact is attached.

SUPPLEMENTAL INFORMATION

Overview

The MCC Board of Directors first selected Malawi as eligible for Compact assistance in FY 2007. Over the subsequent year, the Government of Malawi (GOM) completed detailed analysis of the constraints to economic growth in Malawi, as well as a broad consultative process with the private sector, civil society organizations and members of the general population throughout the country. This constraints analysis identified insufficient and unreliable electricity supplies and high transport costs as principal constraints to economic growth. Through an extensive consultative process with key stakeholders, the GOM developed and submitted concept papers to MCC in April 2009. The proposals detailed projects related to: (a) rehabilitating and modernizing the electricity generation, transmission and distribution system, increasing access to electricity in peri-urban and rural areas, and improving energy sector service delivery; (b) rehabilitating and upgrading transport infrastructure, related to rail, rural roads and marine transportation; and (c) increasing the capacity and effectiveness of public financial management systems and corruption prevention, oversight and prosecution. The high cost and the GOM's capacity constraints led MCC to narrow the scope of projects under consideration. After an extensive internal and external peer review process, the team dropped the rail and marine transport projects and governance project, and in June 2009 moved forward with a subset of the proposed power sector projects.

In support of such, MCC entered a Memorandum of Understanding in April 2009 to provide assistance under Section 609(g) of the Millennium Challenge Act of 2003, as amended, to provide technical assistance in further developing these projects. Following completion of detailed feasibility, financial, and legal studies related to the proposed projects, MCC wishes to enter into Compact negotiations with the GOM.

Program Overview and Budget

The proposed Malawi Power Sector Revitalization Project (the "Power Project") includes three activities: The Power System Modernization and Upgrade Activity, Sector Reform Activity, and Environment and Natural Resource Management (ENRM) Activity. The objectives of each Activity and anticipated goals are described below. The following table outlines approximate costs, economic rates of return (ERRs) and beneficiaries of the proposed Activities, as well as administrative costs. MCC continues to refine the ERRs and beneficiaries, resulting from recent dialogue and changes to Activity design of the Power Project. The ERRs below are based on the realization of the GoM's plans to maintain and expand generation capacity and MCC is seeking firm commitment from GoM in this regard. The Compact total budget is still undergoing MCC review, and is expected to be in the range of \$300 to \$350 million. Information in this memorandum is preliminary and therefore subject to further verification and revision, and the availability of funds.

Proposed Compact Components	Preliminary Cost Estimates (millions of US\$)	Preliminary Estimated Economic Rates of Return	Preliminary Estimated Number of Beneficiaries
Power System Modernization and Upgrade Activity	up to \$261	10-35%	1,000,000-3,000,000
Sector Reform Activity	\$25	10-50%	500,000-2,800,000
ENRM Activity	\$22	20-30%	500,000-1,200,000
Administration: Accountable Entity, Monitoring and Evaluation, Gender, and Audit Services	up to \$42	N/A (Included as costs in ERRs above)	N/A
Proposed Compact Total:	up to \$350	N/A	N/A

Program Rationale and Logic

Malawi's economy is heavily reliant on the export of rain-fed tobacco and other primary agricultural commodities. Gross national product per capita is estimated at approximately \$288 (2008), and high rates of poverty – estimated at 52 percent (2005) – and food insecurity persist. While the economy has grown rapidly in recent years, (for example, 7.7 percent in 2009), manufacturing has essentially stagnated, growing by less than 0.5 percent per annum over this same timeframe. Thus the prospects for sustained growth are weak if the economy does not begin to diversify its exports into non-agricultural and higher-value agricultural activities.

Although Malawi faces other serious obstacles to sustained economic growth in incomes, significant new investment and innovation are extremely unlikely without a dramatic improvement in electricity supply and service. Enterprises unable to rely upon power supplies pay a high cost for back-up generation, lost production, and equipment failure. Without assurance of electricity supplies, prospective and existing enterprises cannot invest, increase productivity, or generate jobs and income.

Malawi's existing power sector supply capacity cannot meet current demand, and as the utility, Electricity Supply Corporation of Malawi (ESCOM), responds to pressures to connect more customers, effective demand outstrips supply, with frequent outages the result. In addition, ESCOM faces serious financial and operational challenges. Replacement and modernization of equipment have been delayed, leading to technical losses, and poor reliability and quality of service.

The three activities that comprise Malawi's proposed Compact are bound by complementary technical and systemic changes that have been developed to lay the essential groundwork for a turnaround of the power sector, and fostering more sustained development and expansion of the sector. Through these investments and reform, future investment in new generation is more feasible and attractive. Therefore, MCC's Compact expects to contribute substantially to sector development resulting in the economic growth and poverty reduction the GOM seeks.

Power System Modernization and Upgrade Activity (“Modernization Activity”)

The Modernization Activity is focused on rehabilitation, upgrade and modernization of ESCOM’s selected transmission and distribution assets that were identified by GOM as requiring the most urgent repair, maintenance and upgrades.

a) Transmission Sub-Activities

This sub-activity includes the construction of a 220kV high voltage power line (the transmission “backbone” of the Malawi power system as currently configured) from Nkula B to Golomoti, that covers the south and central regions. This line will run parallel to existing 132kV lines; the second sub-activity consists of the construction of a 132kV line parallel to existing 66kV and 33kV lines from Chintheche to Lewinga and from Lewinga to Bwengu in the north. These projects are expected to:

- provide a secure transmission link between the southern region and the central region, solving existing unsecure network problems;
- provide an increase in capacity to move bulk power from the south where it is generated to the central and northern regions, solving existing power transfer limitations;
- improve quality of voltage to customers in the central and northern regions, solving existing voltage problems;
- permit rehabilitation of 132kV lines heading north to take place and for those lines to operate at optimal conditions, solving unsecure 132kV network and overloading problems;
- reduce technical losses on these lines; and
- facilitate the transfer of power if/when the Malawi power system is interconnected with the Mozambique system at some future date.

b) Distribution System Upgrade, Expansion, and Rehabilitation Sub-Activity

A number of discrete projects are contemplated under this sub-activity. These projects are spread throughout the southern, central, and northern power systems of the Malawi power network. The proposed improvements fall under the following general categories:

- upgrading (up-rating) of existing network connections (66kV, 33kV, 11kV);
- extension on existing substations;
- up-rating transformers in existing substations;
- installation and/or repair of improved protection systems;
- expansion, rehabilitation and development of new substations;
- new network extensions and connections; and
- installation of new controls and communication systems (SCADA).

These projects are expected to result in the following benefits to customers:

- improved quality of electricity;
- improved power reliability and security of supply;

- enhanced safety for the system and operational efficiency of the ESCOM distribution system; and
- increased power transfer capability.

Sector Reform Activity (“Reform Activity”)

The policy reform initiatives will deal with long standing governance and operational issues in the power sector, both at the utility level and the regulator. Proposed projects include: (1) legal reform and capacity building to improve the regulatory functions, such as tariff setting, at Malawi’s power sector regulator – the Malawi Energy Regulatory Authority; (2) strengthening the financial management and operational controls at ESCOM and upgrades to its information technology systems to allow it to improve its billing and collections functions; and (3) governance reform to strengthen the oversight and management of both MERA and ESCOM, with the goal of improving the sector’s ability to attract much needed private investment.

Environment and Natural Resource Management Activity (“ENRM Activity”)

Two sub-activities have been identified under the ENRM Activity. The first sub-activity concerns management of invasive weeds on the Shire River and sedimentation at the hydro power plants. These actions have been organized to address the immediate short- to mid-term effects of siltation and weed infestation affecting ESCOM’s hydropower assets and operations.

The second sub-activity is focused on understanding and managing causes (rather than symptoms) of the weed and sedimentation problems. The degradation of the Shire River basin imposes a huge cost on the Malawi economy. Sustainable utilization and management of the Shire River ecosystem is needed to ensure the long-term viability of hydropower. The Environmental and Natural Resources Management Action Plan (ENRMAP) sub-activity is expected to provide an integrated assessment of the legal, institutional, socioeconomic, and environmental dimensions of land use and resource management problems that affect the river basin. Based on the ENRMAP, it is expected a number of discrete projects may be implemented to address the effects of siltation and weed infestation.

Partnership Strategy

Since the beginning of the Compact development process, MCC has partnered with development institutions, civil society and the private sector. The earliest example is the collaboration with the GOM, World Bank, African Development Bank and the UK’s Department for International Development to identify the most significant obstacles to long-term economic growth in Malawi. MCC has also engaged with key donors in Malawi about the possibility of partnering to support a comprehensive power sector reform program that could include additional funding for power system rehabilitation and modernization and power sector institutional strengthening and capacity building activities. Civil society and private sector groups have actively participated in Compact development and assisted in advancing the power sector reform agenda.