

## BRIEF NOTE ON THE IDA DPC with Cat DDO

March 2017

### Vulnerability of Bhutan

Located at the foothills of the seismically active Himalayan mountain range between India and China, Bhutan is highly exposed to tectonic as well as hydro-meteorological hazards. In addition to some of the major disasters that Bhutan faced in the last few years which include the 1994 Glacier Lake Outburst Flood, the 2009 and 2011 earthquakes (M6.1 and M6.9 respectively), and the 2009 cyclone Aila, the country faces severe flooding and landslides with every monsoon.<sup>1</sup>

As per the Indian Seismic Code, Bhutan lies in seismic zones IV and V, which are the most active zones. Considering the location and as proven by past earthquakes, earthquakes are one of the most imminent hazards in Bhutan.<sup>2</sup> Recent research shows that Bhutan could experience a destructive earthquake of magnitude over M8, potentially bigger than the major earthquake of M7.5-8.5 in 1714.

Rapid urbanization is another challenge the country faces. The growth rate of Bhutan's urban population is the highest among the eight South Asian countries, at 5.7 percent per year from 2000-2010<sup>3</sup>. The urban growth that provides new opportunities at the same time poses challenges to disaster preparedness in view of mushrooming of residential and commercial buildings.

### Rationale to introduce IDA DPC with a Cat DDO

The Royal Government of Bhutan (RGOB) recognizes the need to enhance its preparedness and response capacity, firstly to reduce loss of lives and livelihoods and secondly to maintain and build on its development gains and economic reforms. In line with this priority, the RGOB is investing at all levels to enhance its preparedness and response capacity. However, financial resources remain a constraint, especially if the country is hit by a catastrophe resulting from an adverse natural event.

While the general understanding as per the Disaster Management Act, rules and regulations that are in place is to reprioritize from planned activities to finance needs in the aftermath of a major disaster, there is no specific tool to be utilized in such a scenario, which may lead to delays in responding to critical needs and adequate planning of recovery and reconstruction.

The IDA Development Policy Credit with a Catastrophe Deferred Drawdown Option (DPC with Cat DDO) can support the RGOB's efforts to be better prepared to face the financial challenges in the case of a major disaster by providing immediate liquidity and complementing existing resources, without distracting ongoing development plans.

### Key Features of the IDA DPC with Cat DDO

The IDA DPC with Cat DDO is a contingent financing line of credit that provides immediate liquidity to countries to address shocks related to natural disasters, including health-related events. It serves as early financing while funds from other sources such as bilateral aid or reconstruction loans are being mobilized.

<sup>1</sup> The cyclone Aila and an earthquake in 2009 in total resulted in damages of approximately 5.7% of the GDP in 2009; the earthquake of 2011 resulted in damages of about 1.4% of the GDP in 2011. The recent monsoon flooding in the southern parts of the country in 2016 resulted in damages of about 0.6% of its GDP.

<sup>2</sup> <http://www.adrc.asia/nationinformation.php?NationCode=64&Lang=en&NationNum=33>

<sup>3</sup> <http://www.worldbank.org/en/country/bhutan/brief/leveraging-urbanization-bhutan>

**Pre-approval criteria:** In order to gain access to the Cat DDO, the recipient must (i) have an adequate macroeconomic policy framework at approval and renewal, but not necessarily for drawdown; and (ii) be preparing, or already have, a satisfactory disaster risk management program, which the World Bank will monitor on a periodic basis during the life of the drawdown period.

**Country limit:** The country limit is set at a maximum of US\$250 million or 0.5 percent of GDP, whichever is lower. Based on this, IDA clients with limits below US\$20 million may request a DPC with Cat DDO up to a maximum of US\$20 million, which is the case of Bhutan.

**Drawdown trigger:** Funds become available for partial or total disbursement after the pre-specified drawdown trigger is met, typically the member country's declaration of a state of emergency, in accordance with its legislation.

**Drawdown period:** Cat DDOs were introduced under the IDA 18 onwards so once the funds are committed for the Cat DDO, the initial drawdown period is three years, which may be renewed once for a maximum of six years in total. Should the country decide to close the Cat DDO after three years or if it expires after six years with partial or total undisbursed balance, the funds can be recommitted so the country won't lose the funds.

**Source of funding:** A country can fund the DPC with Cat DDO through its concessional core IDA allocation envelope. Of the amount requested, 50 percent will be funded by the country's concessional core IDA allocation, with the balance financed by IDA's overall resources<sup>4</sup>. Upon drawdown, IDA concessional rates will apply.

**Pricing:** No commitment fee; front end fee is waived, and renewal fee is currently set at zero.

## Proposed next steps

- (i) MoF and DDM to discuss the operationalization of the CatDDO in the Bhutan context at the appropriate forums within the government.
- (ii) Based on request from the Ministry of Finance, the Bank team mobilizes a team to work with the relevant agencies in the Royal Government of Bhutan to initiate the project design.
- (iii) Discussions on scope, prior actions and triggers with the Ministry of Finance and other relevant agencies.
- (iv) Agreement on DPC with Cat DDO project preparation timeline and implementation modalities with the client.

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<sup>4</sup> This only applies to the Concessional Core IDA Allocation option, and not the other two options.