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**INTERNATIONAL DEVELOPMENT ASSOCIATION  
AND  
INTERNATIONAL FINANCE CORPORATION**

**COUNTRY PARTNERSHIP STRATEGY**

**FOR THE  
KINGDOM OF BHUTAN  
FOR THE PERIOD FY2015–19**

**August 25, 2014**

**Bhutan Country Management Unit  
South Asia Region  
International Finance Corporation  
Asia Region**

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## CURRENCY EQUIVALENTS

Date of last Country Partnership Strategy: October 27, 2010

(Exchange Rate Effective as of April 4, 2014)

Currency Unit: Bhutanese Ngultrum

US\$1.00 = BTN 60

## GOVERNMENT'S FISCAL YEAR:

(July 1–June 30)

## ABBREVIATIONS AND ACRONYMS

<b>AAA</b>	Analytical and Advisory Activities	<b>KPIs</b>	Key Performance Indicators
<b>ADB</b>	Asian Development Bank	<b>MDGs</b>	Millennium Development Goals
<b>BHU</b>	Basic Health Units	<b>MDTF</b>	Multi-Donor Trust Fund
<b>BNB</b>	Bhutan National Bank	<b>MIC</b>	Middle Income Country
<b>BISP</b>	Benazir Income Support Program	<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>BTFFC</b>	Bhutan Trust Fund for environmental Conservation	<b>MSME</b>	Micro, Small, and Medium Enterprise
<b>CPIA</b>	Country Policy and Institutional Assessment	<b>NKRA</b>	National Key Result Area
<b>CPS</b>	Country Partnership Strategy	<b>NLTA</b>	Non-Lending Technical Assistance
<b>CPSPR</b>	Country Partnership Strategy Progress Report	<b>NMES</b>	National Monitoring and Evaluation System
<b>DFID</b>	UK - Department of International Development	<b>NORAD</b>	Norwegian Agency for Development Cooperation
<b>DPC</b>	Development Policy Credit	<b>PDP</b>	People's Democratic Party
<b>DPL</b>	Development Policy Loan	<b>PEFA</b>	Public Expenditure and Financial Accountability
<b>DPs</b>	Development Partners	<b>PER</b>	Public Expenditure Review
<b>DRM</b>	Disaster Risk Management	<b>PFM</b>	Public Financial Management
<b>DSA</b>	Debt Sustainability Analysis	<b>PHRD</b>	Japan Policy and Human Resource Development
<b>EDP</b>	Economic Development Policy	<b>PPP</b>	Public-Private Partnership
<b>EFTCS</b>	Electronic Funds Transfer Clearing System	<b>PPPD</b>	Public Procurement Policy Division
<b>FCPF</b>	Forest Carbon Partnership Facility	<b>REDD</b>	Reduced Emissions from Deforestation and Forest Degradation
<b>FDI</b>	Foreign Direct Investment	<b>RGoB</b>	Royal Government of Bhutan
<b>GDP</b>	Gross Domestic Product	<b>RMA</b>	Royal Monetary Authority
<b>GEF</b>	Global Environment Facility	<b>RTM</b>	Round Table Meeting
<b>GFDRR</b>	Global Facility for Disaster Reduction and Recovery	<b>RUB</b>	Royal University of Bhutan
<b>GNH</b>	Gross National Happiness	<b>SDC</b>	Swiss Development Corporation
<b>GNI</b>	Gross National Income	<b>SME</b>	Small and Medium Enterprise
<b>GTP</b>	Graduate Training Program	<b>SOE</b>	State-Owned Enterprise
<b>IBRD</b>	Int'l Bank for Reconstruction and Development	<b>TA</b>	Technical Assistance
<b>ICR</b>	Implementation Completion and Results Report	<b>TAP</b>	Technical Assistance Program
<b>IDA</b>	International Development Association	<b>TTF</b>	Trade and Transport Facilitation
<b>IDF</b>	Institutional Development Fund	<b>UCS</b>	Use of Country Systems
<b>IEG</b>	Independent Evaluation Group	<b>UNDP</b>	United Nations Development Programme
<b>IFC</b>	International Finance Corporation	<b>UNICEF</b>	United Nations Children's Fund
<b>IMF</b>	International Monetary Fund	<b>WAVES</b>	Wealth Accounting and Valuation of Ecosystems Services
<b>JICA</b>	Japan International Corporation Agency	<b>WBG</b>	World Bank Group

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Map of Bhutan: IBRD 33373R2

The World Bank Group greatly appreciates the close collaboration of Bhutan's authorities in the preparation of this Country Partnership Strategy and the feedback from stakeholders. The preparation of the document involved extensive discussions with government representatives, as well as other stakeholders, for example, the private sector, parliamentarians, the academia, youth groups and civil society. The strategy is a result of a team effort and the document received many useful contributions from the Bhutan Country Team and individuals across the WBG. Although it is impossible to name them all, we gratefully acknowledge and thank them for sharing their guidance, knowledge, and experience.

## I. EXECUTIVE SUMMARY

**i. Bhutan is a (lower) Middle Income Country (MIC) with a good record in reducing poverty and making progress towards achieving the Millennium Development Goals (MDGs).** Its per capita income is US\$2,400 and its estimated annual GDP growth over the next five years is 8 percent. After two successive elections, including a peaceful transfer of power, Bhutan continues to transition toward democracy within a constitutional monarchy and continues to enjoy political stability. Its policy makers are ambitious and reform-oriented and have outlined a unique development vision, where GDP is just one element among other non-monetary aspects to measure people's well-being. The country's mountainous terrain provides a considerable potential for the generation of hydroelectricity, for which India is the main financier and buyer.

**ii. To build on this progress, Bhutan needs to sustain macroeconomic stability while creating a business environment to promote private sector growth and job creation.** The hydro-led growth has created some short-term macroeconomic imbalances, which call for careful management of fiscal and monetary policies. At the same time, it is critical to provide a better investment climate that is more conducive to private sector development, diversification of the economy and job creation. More outsourcing of activities and a shift towards demand-side finance in service delivery should also support the development of the private sector and civil society organizations in infrastructure and the social sectors. In addition, Bhutan's large stock of natural capital calls for increasing its sustainable contribution to the economy, while in doing so protecting the environment and human well-being. Related challenges include rapid urbanization, low agriculture productivity, limited infrastructure, difficult topography, a small market scale and vulnerability to disaster and climate change.

**iii. The proposed World Bank Group (WBG) Country Partnership Strategy (CPS) will support Bhutan's aspirations to achieve sustainable and inclusive growth.** The proposed CPS will seek to protect Bhutan's recent gains in reducing poverty and boosting shared prosperity through continued focus on improving rural livelihoods and managing urbanization, while protecting its natural assets. At the same time, it will focus on the emerging challenges of increasing Bhutan's competitiveness and managing the gains of rapid growth fueled by hydropower development. Here, the WBG will aim to support the government to manage macroeconomic and fiscal imbalances, design a clear fiscal strategy and role for the public sector and improve the business environment to diversify the economy. The CPS will be aligned with the government's 11th Five Year Plan and will organize its activities under three results areas: (i) improving fiscal and spending efficiency, (ii) increasing private sector growth and competitiveness, and (iii) supporting green development. Implementation of the CPS will be monitored through a results matrix.

**iv. Drawing on the lessons of past programs in Bhutan and feedback from stakeholder consultations, the WBG's engagement during this CPS period will aim to be selective and to leverage IDA resources through partnerships and knowledge sharing.** The WBG will exercise greater selectivity by focusing new interventions in areas that are critical for future growth, while building on Bhutan's past achievements in poverty reduction through the existing portfolio. New interventions will aim to strengthen the investment climate to spur private sector growth and job creation and to facilitate regional connectivity so landlocked Bhutan can reap the benefits of proximity to the vibrant markets of India and Bangladesh. Much of this work will be supported through analytical work and technical assistance. The main envisaged financing instruments include a series of Development Policy Credits (DPC) and investment loans (including potentially regional IDA resources) to finance trade and transport infrastructure to support intra-regional

trade. Given the limited resource envelope for Bhutan, the WBG will leverage additional resources—financing and non-financing—to meet Bhutan’s growing needs along three fronts: (i) increased coordination within the WBG; (ii) partnerships with other donors; and (iii) supplementing of IDA financing with technical assistance and analytical work.

**v. Risks exist but mitigation measures are also in place.** The most significant risks could emerge potentially from political resistance to reforms, macroeconomic imbalance stemming from internal and external factors, weak local implementation capacity and vulnerability to natural disasters and climate change. While these risks could pose implementation delays and impact the achievement of CPS objectives, the CPS program is designed to mitigate those risks as much as possible.

## II. COUNTRY CONTEXT

1. **The Kingdom of Bhutan is a unique country with promising development opportunities.** Nestled in the eastern Himalayas between China and India, Bhutan's terrain comprises steep mountains crisscrossed by snow-fed rivers with considerable hydropower generation potential. This small country (population about 750,000) has a rich and unique cultural heritage, in part due to its relative isolation during much of the last century. The government has designated nearly half the land as a protected area to help preserve biodiversity. Agriculture is the main source of livelihood for more than half the population, but contributes less than one-fifth of GDP. Forestry, tourism, and the sale of electricity to India are other key contributors to the economy.

2. **Within this context, the World Bank Group (WBG) has to find new way of partnering, focusing on knowledge, innovation, and transformational engagement.** Bhutan is now a lower middle-income country with a strong poverty reduction record. Bhutan's policymakers are ambitious, selective and reform-oriented, and have outlined a unique and balanced development vision—where Gross Domestic Product (GDP) growth is just one element to enhance peoples' happiness—combined with strong political commitment and good governance. Its GDP per capita is already above \$2,400 and it is poised for 8 percent annual growth over the next five years. It has done remarkably well on poverty alleviation and providing services to citizens, even in the remotest corners of the country. The Bhutan Country Partnership Strategy (CPS) FY2015-2019, which brings together the International Development Association (IDA), International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA), outlines how within Bhutan's unique context and the government's priorities, all three entities will work together to provide knowledge, hands-on technical assistance, policy dialogue and financing.

### A. Social and Political Context

3. **Bhutan's political system evolved rapidly over the past decade from an isolated absolute monarchy into a democratic constitutional monarchy, with a remarkable degree of stability and continuity.** The widely-respected fourth King, Jigme Singye Wangchuck, oversaw the process of transition to constitutional monarchy. In 1999, the King lifted the ban on television and the Internet, making Bhutan one of the last countries in the world to do so. In 2005, he introduced a new constitution, and in 2008 he voluntarily abdicated in favor of his son, Jigme Khesar Namgyel Wangchuck, who, then 28, became the world's youngest reigning monarch. Also in 2008, Bhutan held its first national elections. While the historical party dominated that first Parliament, in the 2013 elections the opposition People's Democratic Party (PDP) won a majority and formed a government under Prime Minister Tshering Tobgay. In its election pledges, the PDP outlined its vision for the country of greater decentralization, civil service efficiency, incentives for green industries, and balanced regional development with meaningful engagement of the private sector and foreign investment in the economy.

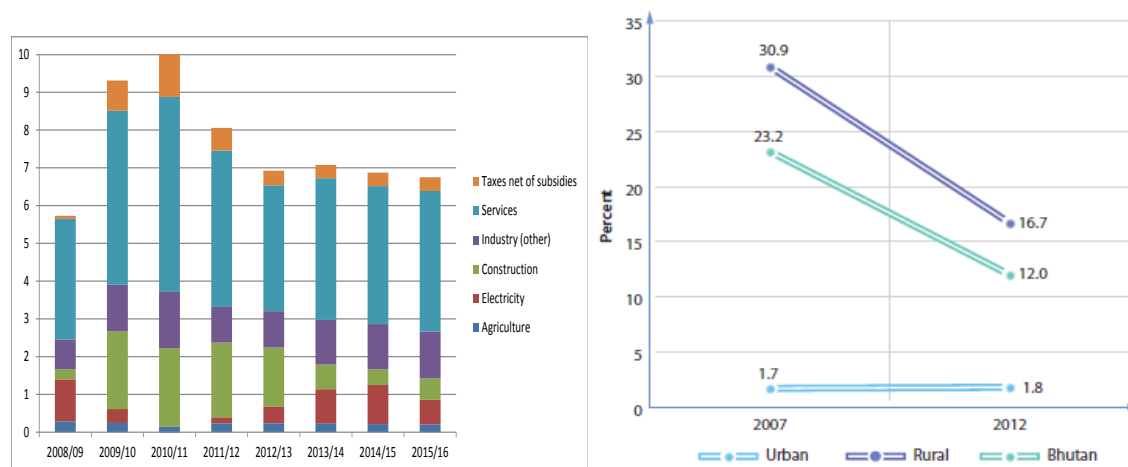
4. **Bhutan maintains strong economic, strategic and military relations with neighboring India.** As a landlocked country, Bhutan is largely dependent on India as a trading partner and transit country; India accounts for 97 percent of Bhutan's exports and about 90 percent of its imports. India is the main financier and buyer of Bhutan's hydropower, and also its main provider of foreign aid. Bhutan also maintains a one-to-one peg of its currency, the Ngultrum, with the Indian rupee. In 2007, Bhutan and India signed a new treaty that clarified

Bhutan’s own control over its foreign relations. Beyond India, Bhutan could potentially benefit from untapped regional opportunities that include stronger links with Bangladesh through regional transport connectivity as well as power-trading.

## B. Bhutan’s Progress on Poverty Reduction and the MDGs

5. **Thanks to broad-based and inclusive economic growth over the past decade, poverty in Bhutan has declined rapidly.** The World Bank’s 2014 Poverty Assessment shows that the share of Bhutan’s population living below the national poverty line<sup>1</sup> was effectively cut in half between 2007 and 2012, from 23.2 to 12 percent (Figure 1). Bhutan has nearly ended extreme poverty within the living memory of a generation – to only 2 percent of Bhutanese living below the international poverty line of \$1.25/day in 2012. Broader multidimensional poverty indices, which track progress on other dimensions, including health and education, indicate a decline in deprivation from 30 to 10 percent of the population. Economic growth in Bhutan has been pro-poor: not only did the headcount poverty rate decline, but the poverty gap also declined with the bottom 40 percent enjoying rapid growth in income. However, regional disparities persist and poverty in rural areas, at 16.7 percent, is still considerably higher than in urban areas, at 1.8 percent.

**Figure 1: Growth is strong and poverty has dropped**



Source: Bhutan National Statistical Bureau and World Bank Staff calculations

6. **Given the relatively higher levels of poverty in rural areas, the main drivers of poverty reduction are those that impact rural Bhutan.** While hydroelectric projects had a strong positive impact on overall income levels, they depend largely on spillover effects—e.g., roads expansion, and jobs and business opportunities in the project areas—to impact poverty. A more direct driver of poverty reduction appears to be the increasing commercialization of agriculture and expansion of the rural roads network. Fueled by the recently renewed free trade agreements with India and preferential market access to Bangladesh, exports of commercial crops have increased sharply. The expansion in rural roads and increased highway linkages along the Indian border and north-south brought construction jobs and reduced travel times and costs for goods and people.

<sup>1</sup> The national poverty line in Bhutan is Nu 1,704.84 (about \$28.4) per person/month.



7. **Bhutan has made good progress in extending gains beyond GDP growth.** As shown in Annex 3, Bhutan has already achieved or surpassed targets within five of seven MDGs and remains on track to achieve all MDG targets. Most notably, Bhutan achieved the target for halving extreme poverty ahead of time, reached gender parity in primary education and significantly reduced maternal mortality rates. In some areas, Bhutan has surpassed its neighbors from worse initial conditions: for instance, maternal mortality in 1990 was 1,000 per 100,000 live births compared to India's 600, but by 2011 it was 180 per 100,000 live births compared to 200 in India.

8. **Significant progress has also been made towards greater gender equality.** Enrollment in primary schools stood at 96 percent in 2013 and nationwide almost half of primary school students were girls, in stark contrast to 1970 when only one girl was enrolled in school for every 50 boys; moreover, women's labor force participation is now almost on par with men. While Bhutan has made tremendous progress toward gender equality in human development and the labor market, gender gaps still persist--related to job quality, while land inheritance and family obligations- continue to constrain women's economic mobility.

9. **Despite this significant progress, some challenges remain.** Bhutan has not managed to make sufficient progress on reducing malnutrition, especially among children where stunting is an issue, and women, a challenge acknowledged at the highest political level. Other areas requiring attention are gender parity in tertiary education, HIV and youth unemployment. The big reduction in poverty has been accompanied by vulnerabilities, especially for women and the chronic poor. The absence of formal social protection and targeting mechanisms has created a poverty trap. Urbanization is on the rise, with Thimphu, the capital city,<sup>2</sup> drawing the greatest number of rural—mostly young and male—migrants, with women remaining less mobile because of family responsibilities and land inheritance practices. While the poverty incidence of female-headed households is about the same as for male-headed households, they are less upwardly mobile and have fewer coping resources. Young people migrate to study or for economic reasons, but support systems to facilitate their transition to productive employment (microcredit, skills training, urban safety nets) are lacking. In 2012, two-thirds of all poor Bhutanese were chronically poor; for every ten who moved out of poverty, four fell back into poverty.

### C. Recent Economic Developments

#### *Growth and Inflation*

10. **Spurred by the hydropower sector, economic growth has accelerated over the past decade.** GDP growth in Bhutan averaged around 9 percent per year during this period. The agriculture, manufacturing and mining sectors grew at consistent rates: agriculture at a low 2 percent, manufacturing and mining maintained at close to 12 percent. In 2007, the commissioning of the 1,020MW Tala hydropower project led to a sharp rise in domestic electricity production. During the 2007-2012 period, following commencement of construction of the Punatsangchhu I and II, Mangdechhu, and Dagachhu power plants (which collectively will bring Bhutan's hydroelectric power generation capacity to over 7,000 MW), the construction sector experienced a boom reaching 9 percent growth per annum, while service sector growth rose to 11 percent per annum. Import demand has surged in recent years, in large part due to

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<sup>2</sup> Thimphu, the national capital, and the town of Phuntsholing adjacent India are the country's two biggest cities (but less than 100,000 residents each).

higher demand for capital equipment for the power plants under construction and expansion of domestic aggregate demand

11. **With 75 percent of Bhutan's imports coming from India and an exchange rate pegged to the Indian rupee, Bhutan's consumer inflation is intimately linked to India's.** Food and beverages have the largest share in Bhutan's consumer price index, at 36.9 percent, and since these are mostly imported from India, they will continue to have the strongest impact on overall inflation, which rose to nearly 10 percent per annum over the FY11-14 period (Table 1). Despite the recent ease in inflation in India, it is expected that inflationary pressures in Bhutan will remain elevated throughout 2014.

**Table 1: Selected Macroeconomic Indicators (FY09-FY13)**

	2008-09	Actual 2009-10	2010-11	2011-12	Estimated 2012-13
<b>Output and prices</b>					
Real GDP growth (%)	5.7	9.3	10.1	6.5	5.0
CPI inflation (average)	7.1	4.8	8.6	10.1	8.7
<b>Public Finance (%GDP)</b>					
Total revenue and grants	35.6	46.3	35.6	35.2	28.9
Total expenditures and net lending	33.3	44.7	37.7	36.5	32.9
Overall balance	2.3	1.6	-2.1	-1.3	-4.0
Public debt	71	57	69	72	90
<b>External accounts</b>					
Exports (goods) (USD million)	516	544	665	595	601
Imports (goods) (USD million)	607	843	1185	1072	1062
Grants (USD million)	151	261	254	273	191
Current account balance (% GDP)	-1.6	-9.9	-23.5	-19.0	-22.8
Gross official reserves (USD million)	773	813	904	800	904
In months of GNFS imports	9.9	7.5	8.9	8.0	8.8
<b>Money and credit</b>					
Private sector credit (% change)	29.3	22.8	19.2	20.7	6.2
Broad Money (% change)	24.6	30.1	21.2	-1.0	18.6
<b>Memorandum items</b>					
Ngultrum per dollar (period average)	47.8	46.7	45.3	50.3	-
GDP (Ngultrum billion)	58.0	66.9	79.2	92.7	106.1
GDP (USD million)		1421	1714	1852	1815

*Source:* Bhutanese authorities and IMF estimates

### *External Debt*

12. **Despite the high level of external debt, the risk of debt distress continues to be moderate.**<sup>3</sup> Bhutan's public and publicly guaranteed external debt was 85 percent of GDP by end-FY13, adding 14 percentage points of GDP to the previous year. The public external debt-to-GDP ratio is expected to rise to 121 percent in 2016/17 and then decline gradually. The rise in the external public debt has been driven in large part by hydro sector-related external borrowing (48 percent of GDP). Hydropower projects have so far been financed primarily by India with a mix of loans (70 percent) and grants (30 percent). The risk assessment is based on the commercial viability of the hydropower projects, the risk-sharing agreement with India for hydropower loans, Bhutan's strong track record of project implementation, rapid growth in energy demand from India, committed donor support, and Bhutan's high level of international reserves.

<sup>3</sup> According to the 2014 Joint Bank-Fund Debt Sustainability Assessment; Bhutan is on a two-year Article IV cycle. The Article IV review and Debt Sustainability Assessment were presented to the IMF Board in June 2014.

### *Near Term Challenges and Risks*

13. **Hydro-led growth creates important short-term macroeconomic imbalances, which call for careful management of fiscal and monetary policy.** The construction phase of hydroelectric dams is associated with lumpy financial inflows from India. There are also jumps in foreign exchange earnings every time a hydroelectric dam reaches its generation phase. These large inflows are behind Bhutan's widening current account deficit (see Table 1). In parallel, donor grants and loans are financing about 40 percent of the budget. Large inflows support the development of Bhutan but if they are not adequately managed they become a source of macroeconomic instability. Their lumps and jumps create a pressure for the prices of non-tradable goods and services, and especially the prices of land and labor, to increase substantially. For businesses producing non-tradable goods and services (mainly construction services), these price increases make real interest rates negative and boost the demand for credit.

14. **Credit to the private sector grew significantly in recent years, contributing to the expansion of domestic demand and amplifying external pressures.** Private sector credit has grown at a median 30 percent during FY02-11, from 11 to 49 percent of GDP. This compares with a median 32 percent for lower middle-income countries (16 percent for low-income countries), and coincides with the median of 49 percent for South Asia. The rapid expansion stemmed from an initially low base, growth in civil services wages, spillovers from large hydropower projects and loose monetary conditions. In addition, in the absence of alternative investment opportunities, non-banks also have engaged in lending. Emergency prudential measures taken by the central bank in 2012 and 2013 to address the credit boom and ensuing rupee shortage included a total ban on new lending in the housing and transport sectors and various macro-prudential measures. These measures, combined with bans on vehicles imports, successfully slowed down private-sector credit growth and overall aggregate demand.

15. **Containing the external pressures and reducing macroeconomic volatility will require a tighter management of aggregate demand.** Over the next 4 to 5 years, fiscal consolidation measures and a tighter monetary policy are needed. Fiscal policy measures include rationalizing taxes, increasing the efficiency of public spending, limiting unnecessary expenditures without compromising the effectiveness of public service, limiting the growth of the civil service and emphasizing quality as opposed to quantity of jobs. Monetary conditions should be tightened to avoid prospective overheating and manage pressures on rupee reserves. Liquidity conditions should be closely monitored and adjusted to prevent excessive credit growth. Hydropower-related inflows and aid flows should be sterilized to dampen inflation pressures and credit growth and thereby manage import growth.

16. **Strengthening financial sector stability supervision will also be critical in the short-to medium-term.** Rapid credit growth of the kind seen in Bhutan often leads to deterioration in credit quality. Banks appear to be well capitalized, with the risk-weighted capital adequacy ratio rising to 19 percent in 2013. Non-performing loans reportedly declined to around 9.6 percent at the end of 2013 which partly reflects rapid credit growth. Even so, the increase in the loan-to-deposit ratio to above 100 percent raises concerns, given the overall decline in deposits. Financial sector vulnerabilities also arise from growing asset-liability mismatches, with a significant proportion of the deposit base being corporate deposits, whereas bank credit is concentrated in loans with longer time horizons to finance investment projects (e.g., large infrastructure projects). The concentration of lending in personal and real estate loans raises particular concerns; more than a quarter of the financial sector's portfolio consists of building

and construction loans, followed by personal loans which constitute around 16 percent of overall credit outstanding.

17. **Even though gross international reserves are at comfortable levels, they could vanish rapidly in the absence of tightening of aggregate demand.** International reserves amounted to about \$921 million (13 months of merchandise imports) by end-November 2013,<sup>4</sup> but with 88 percent of these reserves in convertible foreign exchange and the remaining 12 percent in Indian rupees, there is a continuing mismatch in the composition of Bhutan's reserves and the structure of its international transactions, as the country primarily needs Indian rupees for trade settlement and debt service. Moreover, convertible reserves have accumulated over the years from external assistance, tourism and hydropower earnings. They could rapidly decrease without the appropriate policy stance in place.

#### D. Economic Prospects and Medium-Term Outlook

18. **Bhutan's medium-term economic outlook is favorable, underpinned by the expansion of hydropower capacity, with manageable macroeconomic risks.** The government plans to ramp up power generation capacity to more than 10,000 MW by 2020, up from around 1,500 MW today (Table 2). GDP growth is projected to average 10 percent over the course of the 11<sup>th</sup> Five-Year Plan (FYP) 2013-2018, powered initially by construction of hydropower plants followed by electricity sales in the outer years, the spillover effects as well as continued robust growth in services. The current account deficit is projected to widen considerably to 26 percent of GDP by FY16, as additional hydropower projects enter the construction (and import-dependent) phase. The increase in construction and electricity generation activity in Bhutan could boost per-capita income from \$2,400 at present to nearly \$5,000 by 2018/19.

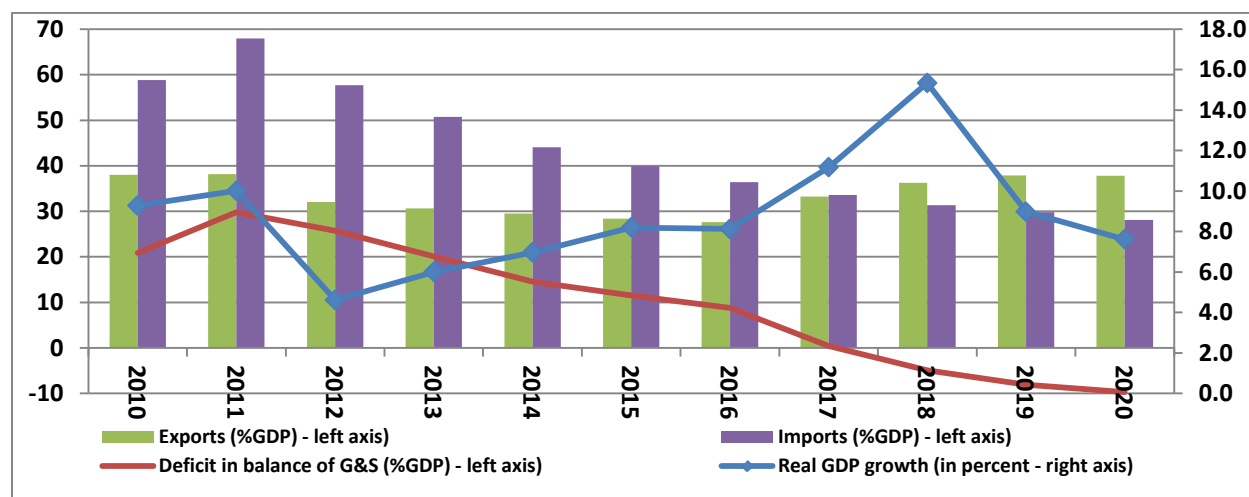
**Table 2: Actual and planned hydropower developments**

	Project name	Cons. start date	Initial Investment (Nu. million)	Actual Investment (Nu. million)	Com Date	Annual Revenue (Nu. million)	Capacity (MW)	Development model
				2012		2012		
<b>Commissioned</b>								
1	Chhukha	1974		2,500	1988	3,270	336	inter- gov
2	Tala	1997	14,080	42,355	2007	6,381	1020	inter- gov
3	Basochu	1997	(up) ATS 350 (low) 1,422	3,565	2001/04	357	64	Austria gov
4	Kunichhu	1995	2,550	5,640	2001	471	60	inter- gov
<b>Under Construction</b>								
1	Punatsangchhu I	2009	35,148	82,592	2017		1,200	inter- gov
2	Punatsangchhu II	2011	37,778	68,262	2017		1,020	inter- gov
3	Mangdechhu	2011	28,963	36,573	2018		720	inter- gov
4	Dagachhu	2009	8,160	12,226	2014		126	PPP
<b>Planned &amp; confirmed</b>								
1	Kholungchhu	2014	37,361				650	JV
2	Chamkharchhu	2014?	69,329				770	JV
3	Bunakha	2014?	29,963				180	JV
4	Wangchhu	2014?	46,387				570	JV
<b>Planned</b>								
1	Amochhu storage		43,777				540	inter- gov
2	Sankosh Storage		129,047				2,560	inter- gov
3	Kuri-gongri		211,677				2800	inter- gov
4	Nikachu		11,965				118	PPP
5	Gamrichhu		9,153				102	PPP
6	Rotpashong		109,976				1230	PPP
7	Khomachhu		28,071				363	PPP
8	Nyera Amari		46,415				473	
<i>Memo: 2012 GDP: Nu109.491 billion (US\$1.8 billion), Government domestic revenues: 37.65 billion</i>								
<i>Source: RMA Annual report 2012-2013 &amp; DGPC</i>								

<sup>4</sup> The Constitution requires that foreign exchange reserves should be maintained at 12 months of essential imports.

19. **Over the medium- to long-term, it will become important to stabilize increasing foreign exchange inflows and crowd in private sector development.** Bhutan is subject to step-wise increases in foreign exchange inflows as major power plants begin exporting electricity, but also as new plants are being built with external finance. These rapid inflows have posed a challenge in the past, with shocks coming from both the construction and generation phases of large hydropower projects. Looking forward, foreign exchange-based public revenues as a share of GDP will increase substantially, as more hydropower projects start construction and generation. In the near term, starting in 2017/18, the next three major hydropower plants are expected to add about 4 percentage points of GDP to domestic revenues.<sup>5</sup> Because foreign exchange revenues enter through the budget, Bhutan could face increasing pressures to expand public sector employment and increase public sector wages.

**Figure 2: Growth and revenues are expected to pick up with the commissioning of hydro-projects**



Source: Government Medium-term fiscal framework

20. **A public finance strategy and strengthened fiscal rules could contribute to laying out clear development goals for public finance,** in particular for financial stabilization and the development of the private sector by shifting finance from the supply to the demand side, from infrastructure maintenance to education and health non-core services.<sup>6</sup> A strong institutional mechanism with transparent and simple rules will help avoid pressure to spend electricity revenues on public employment and growing the public sector. In addition to fiscal and monetary policies to manage financial inflows, achieving a more effective and efficient management of public finance will provide some of the much-needed additional fiscal space. Specifically, improving the efficiency of tax policy and administration, fiscal management and risk analysis, improving financial reporting, strengthening the capacity of the Ministry of Finance, supporting

<sup>5</sup> Punatsangchhu 1 and 2, and Mancegchhu hydropower projects.

<sup>6</sup> The 11<sup>th</sup> five-year plan places the establishment of a stabilization fund as one of the key macroeconomic recommendations to: (i) sterilize inflows from hydropower exports and related loans and grants; (ii) reduce volatility in liquidity and credit; (iii) enable government to support counter-cyclical interventions to sustain the desired level of growth in the economy; (iv) support priority investments and private sector development; (v) invest in foreign government bonds.

internal and external audit oversight functions and strengthening procurement are some of the priorities where Bhutan can improve the use of scarce public resources.

### **E. Private Sector Development and Jobs**

21. **Hydropower contributes 12.5 percent of GDP directly and up to 30 percent taking into account indirect contribution through construction and ancillary activities, as well as 30 percent of exports earnings (50 percent by 2017/18) and 20 percent of government own revenues.** Hydropower also contributes to job creation by supplying reliable electricity for firms, and through induced and indirect effects within and outside Bhutan, even employment directly resulting in Bhutan accounts for only 2 percent of the total. In the longer term, hydropower development is expected to create positive impact on Bhutanese economy where currently the majority of Bhutanese work in agriculture, mostly at the subsistence level, or services. The country has a potential to build on its small but growing energy-intensive industrial sector, notably ferro-silicon industries located close to the Indian border, and to benefit from cheap domestic energy. Tourism also has potential, which is tempered by the challenge of building costly infrastructure in a remote mountainous terrain. Agribusiness is also a sector of opportunities. But all of these potentials need more effort to be realized.

22. **Rising youth unemployment calls for bold reforms to promote private sector growth and job creation.** While total unemployment remained low at 2.9 percent in 2013, youth unemployment was 9.6 percent and is on the rise. In addition, there is evidence that underemployment is large, especially in rural areas. There is also anecdotal evidence of the labor mismatch, with young graduates showing preference for white collar jobs, particularly in the public sector which offers security, stability and benefits. Among the educated youth, the expectation to work in the public sector as the resources provided by electricity sales abroad increase could become a strong deterrent of active job search and entrepreneurship. Some evidence of this trend is already apparent, with Bhutan facing a growing number of vacancies in the private sector and increasingly relying on Indian labor for blue collar and construction jobs

23. **The government has embarked on an ambitious plan to improve its position in the World Bank's annual *Doing Business Report* ranking,**<sup>7</sup> where it ranked 141 out of 189 countries in 2013. Due to the report's narrow focus on regulations, any improvement in the rankings will only be useful if it leads to an increase in private investment and jobs. Regulatory reforms therefore have to be accompanied by a review of other private sector investment constraints. Current constraints cited include the Foreign Direct Investment (FDI) policy, rules on labor imports and construction, high telecom connectivity prices, cumbersome licensing procedures, limited access to finance especially for small firms, and last but not least, challenging domestic and regional connectivity.

### **F. Spatial and Green Development**

24. **Bhutan is undergoing a transition from a rural economy to a more urban society.** The average annual urban population growth rate has been around 4 percent since 2007. Even though Bhutan is relatively well positioned to meet the challenge of rapid urbanization, given its

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<sup>7</sup> The Prime Minister with his Cabinet committed to placing Bhutan in the top 100 countries of the *Doing Business report* ranking within 2 years and issued in March 2014 an executive order assigning responsibilities among Cabinet members.

small population, urban institutional and governance systems need to be strengthened. Spatial planning is also needed, as lack of affordable housing for lower-income groups is becoming a critical issue. As noted earlier, an important challenge is to provide for jobs for an increasingly urban youth population.

25. **However, Bhutan will also remain, for the foreseeable medium-term, a predominantly agriculture-based society.** The agriculture sector provides livelihood to 62.2 percent of the total population, contributing to 12 percent of GDP. While agriculture contribution to GDP has been declining, it continues to be the key source of employment and driver for reducing poverty. But the sector's growth is insufficient adequately to address poverty and attain food security. Migration from rural to urban areas is increasing and has resulted in a shortage of agriculture labor. A range of policies are needed to improve rural life. Physical access to rural areas and between rural areas and markets needs to be improved. Production needs to be modernized and greater access to credit and technology, and sustainable approaches to pest and wild life encroachment are critical.

26. **Given its pristine and unique eco-system, conservation of environmental and cultural assets is one of the cornerstones of Bhutan's development approach.** Bhutan is endowed with dense and virtually untouched forests, unclimbed mountains, abundant water resources and great biodiversity in its flora and fauna. Bhutan is considered a global ecological hotspot. Nevertheless, it confronts chronic pressures primarily related to land degradation, which can stem from the pressures imposed by agriculture production and mining practices, overgrazing, and excessive forest harvesting, as well as solid waste disposal in and around population centers. Threats to biodiversity include illegal forest harvesting, human-wildlife conflict, poaching, and habitat fragmentation arising from land development projects.

## G. Policy and Institutions

27. **On the policy and institutional side of the public sector, Bhutan fares well.** Its Country Policy and Institutional Assessment (CPIA), at 3.6, rates the highest within South Asia. Bhutan ranks 31<sup>st</sup> among 177 countries in Transparency International's 2013 Corruption Perception Index; domestic perception of corruption is also on the decline.<sup>8</sup> The country made progress in public financial management (PFM) including budget preparation, execution, control, reporting and oversight. Parliament increasingly pays attention to the budget approval process and reviews the audit observations through the public accounts committee. The public increasingly demands more government transparency and efficiency.

28. **But implementation capacity remains a challenge.** Bhutan has made headway in the use of country systems for donor projects for financial management and is well positioned to move towards full use of country systems, including procurement. Yet institutions are still relatively young and capacity is concentrated in few. Rules and regulations have become cumbersome, as reflected in Bhutan's *Doing Business* ranking. In addition, well intended environmental clearance processes are impeding job creation.

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<sup>8</sup> Bhutan scored 8.37 in the 2012 National Integrity Assessment Survey compared to 7.44 in 2009 (0 = highly corrupt; 10 = highly transparent).

### III. THE GOVERNMENT PROGRAM

29. **Bhutan’s 11<sup>th</sup> Five Year Plan (FYP; 2013-2018) has been formulated with the objective of “self-reliance and inclusive green socio-economic development.”**<sup>9</sup> The FYP is Bhutan’s medium-term development planning framework, which continues to be guided by the development philosophy of Gross National Happiness (GNH).<sup>10</sup> A notable development in the 11<sup>th</sup> plan is the adoption of a results-based planning framework that articulates 16 National Key Result Areas (NKRAs), i.e., national outcomes and outputs to be achieved over the next five years. Achievement of each NKRA is measured by corresponding key performance indicators, such as GDP growth rates, the GNH index, etc. The 16 NKRAs, categorized under the four GNH pillars, are presented in Table 3.

**Table 3: Bhutan's National Key Results Areas**

<b>Sustainable and Equitable Socio-economic Development</b>	<b>Preservation and Promotion of Culture</b>	<b>Conservation and Sustainable Utilization and Management of the Environment</b>	<b>Promotion of Good Governance</b>
<ul style="list-style-type: none"> <li>• Sustained economic growth</li> <li>• Poverty reduced and MDGs plus achieved</li> <li>• Food security</li> <li>• Full employment</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthened Bhutanese identity, social cohesion and harmony</li> <li>• Indigenous wisdom, arts and crafts promoted for sustainable livelihood</li> </ul>	<ul style="list-style-type: none"> <li>• Carbon neutral/green and climate resilient development</li> <li>• Sustainable utilization and management of natural resources</li> <li>• Water security</li> <li>• Improved disaster resilience and management</li> </ul>	<ul style="list-style-type: none"> <li>• Improved public service delivery</li> <li>• Strengthened democracy and governance</li> <li>• Gender friendly environment for women’s participation</li> <li>• Reduced corruption</li> <li>• Safe society</li> <li>• Needs of vulnerable groups addressed</li> </ul>

30. **The 11<sup>th</sup> FYP places special emphasis on monitoring and evaluation (M&E) based on the National Monitoring and Evaluation System (NMES).** It will give particular emphasis to institutionalizing M&E of programs and projects through the NMES. A Mid-Term Review will assess progress in plan implementation and make necessary adjustments in policies, programs and projects, and the allocation of resources. A round table meeting at the Plan’s inception helped to sensitize development partners to its priorities and policies. Another meeting at mid-term will share progress in implementation. In addition, the government will hold bilateral consultations with development partners, to review programs and projects reviews, and progress on results.

<sup>9</sup> The 11th FYP, approved by Parliament in October 2013, is the second plan to be implemented since the introduction of a democratic constitutional monarchy in 2008. The plan defines “self-reliance” as being able to meet all national development needs as articulated through the Five Year Plans by 2020; “inclusive social development” as reducing poverty and inequality by enhancing the standard of living and the quality of life of the most vulnerable sections of society; “green development” as ensuring carbon neutral development at all times.

<sup>10</sup> Article 9-2 of the constitution directs the state “to promote those conditions that will enable the pursuit of Gross National Happiness”. GNH has been operationalized through the introduction of the GNH Index in 2008 and the GNH Policy Screening Tool in 2009.



## IV. WORLD BANK GROUP PARTNERSHIP STRATEGY FY2015-19

### A. Lessons Learned from the last CPS and Stakeholder Consultation

31. **A self-evaluation by the Country Team as well as lessons learned from five previous Bhutan operations<sup>11</sup> assessed by the Independent Evaluation Group (IEG) informs the new strategy.** The CPS Completion Report (Annex 3) includes a detailed description of lessons learned. Key lessons for the Bank's engagement in Bhutan are:

- **Policy-based financing creates unique opportunities for the WBG's engagement in Bhutan.** As described in the CPS Completion Report, the WBG moved increasingly toward development policy financing (DPF) in FY11. This shift in instruments was made in parallel with the country's structural transformation toward a hydropower-led economic growth model and provided an important entry point for dialogue on the structural, macroeconomic and fiscal challenges. Programmatic development policy financing, taking advantage of synergies with parallel projects in private sector development, education, procurement and basic infrastructure, enabled the WBG better to respond to the government's demands and to support the implementation of key policy reforms in a well-sequenced and incremental manner. Going forward, the WBG will build on past support for policy reforms to help foster a reform constituency and to sustain the momentum.
- **The WBG's policy-based engagement in Bhutan needs to be accompanied by better prioritized and sequenced analytics, technical assistance and financing.** The ongoing WBG program in Bhutan consists of too many small and fragmented activities without a clear link to the broader reform areas which the program aims to support. Bhutan's limited IDA resource envelope makes it all the more necessary to prioritize and sequence activities to enable the WBG to contribute to the national development vision. Since institutional capacity poses a key constraint for reforms, a full integration of analytical work, technical assistance, investment financing and policy financing will be important to maximize results. The ongoing DPF series has already mobilized technical assistance to build institutional capacity, an approach that will continue during this CPS period. In addition, the DPF series will continue to be informed by key analytic work to provide a sound foundation for crosscutting issues and linkage across policy areas.
- **Capacity building constraints must be identified and mainstreamed more clearly in the CPS program.** Each IEG evaluation for the WBG Bhutan portfolio highlighted the need to improve capacity in various areas: (i) M&E should be tailored to the country's limited capacity, (ii) project design and results indicators should be simple, (iii) effort should focus more on building country systems rather than targeting delivery to particular groups, and (iv) project implementation needs to be tailored to local situations.

#### *Stakeholder Consultations*

32. **To inform CPS preparation, the WBG conducted extensive stakeholder consultations** with representatives from government, private sector, civil society organizations

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<sup>11</sup> In education, HIV/AIDs, institutional capacity building, roads and private sector development.

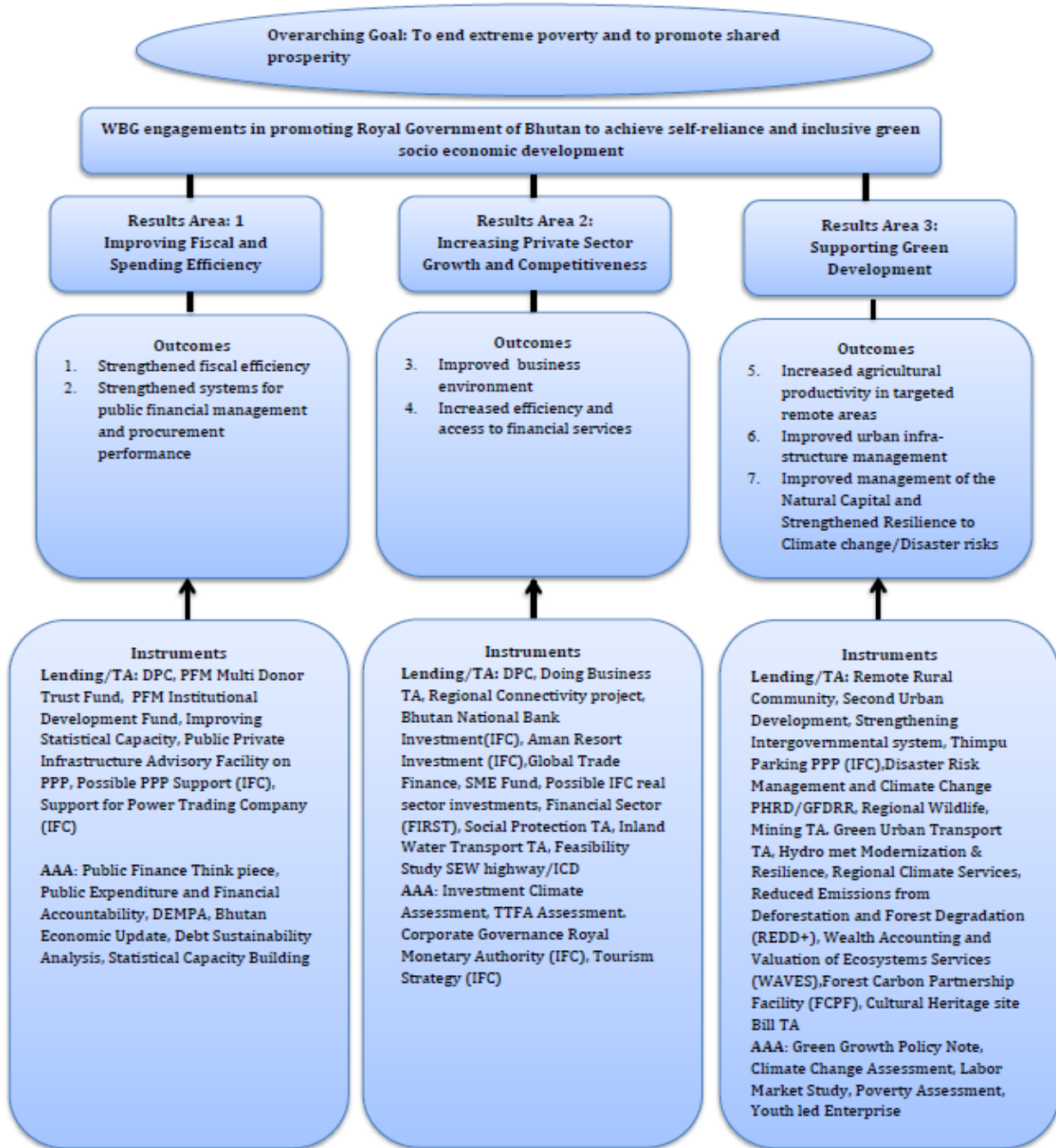
and media. The feedback which emerged during the consultations emphasized several priority areas for Bhutan's development:

- Fiscal sustainability is key to Bhutan's growth and development. Given the country's high public debt and heavy reliance on hydropower, improving fiscal policies will be critical for creating an enabling environment for investment.
- Economic diversification will be vital for attracting job seekers and providing incentives. Retirement and pension benefits for the private sector need to be more efficient and better aligned with the public sector.
- Agriculture and food security issues remain a concern, as many Bhutanese believe that Bhutan relies too heavily on food imports. This would require investment in agriculture infrastructure, finance and commercialization.
- The business environment would benefit from revisions to existing business regulations and policies. The development partners need to work with the private sector to formulate a private sector strategy.
- The WBG should provide technical assistance through knowledge work and policy dialogue in areas where lending is not feasible due to limited resources.
- Investment in culture is deemed to be an important priority for Bhutan. It can also contribute indirectly to the economy through stemming rural- urban migration, increasing social cohesion and promoting tourism.

### **B. Proposed WBG Partnership Strategy**

33. **The overarching goal of the Bhutan CPS (FY15-19) is to support Bhutan's aspirations to achieve sustainable and inclusive growth.** As noted above, the historic drivers of poverty reduction in Bhutan have been increasing commercialization of agriculture, improved road connectivity and hydropower development. The proposed strategy will seek to protect Bhutan's recent gains in reducing poverty and boosting shared prosperity through continued focus on improving rural livelihoods and managing urbanization, while protecting its natural assets. At the same time, it will focus on the emerging challenges of increasing Bhutan's competitiveness and managing the gains of rapid growth fueled by hydropower development. Here, the WBG will aim to help the government to manage macroeconomic and fiscal imbalances and improve the business environment to diversify the economy. The CPS will be aligned with the government's 11<sup>th</sup> Five Year Plan and will organize its activities under three results areas: (i) improving fiscal and spending efficiency, (ii) Increasing private sector growth and competitiveness, and (iii) supporting green development.

Figure 3: Bhutan CPS Results Chain – Results Areas and Outcomes



34. Drawing on the lessons of past programs in Bhutan and feedback from stakeholder consultations, the WBG’s engagement during this CPS period will aim to be selective and to leverage IDA resources through partnerships and knowledge sharing.

- **Selectivity.** The WBG will exercise greater selectivity by focusing new interventions in areas that are critical for future growth, while building on Bhutan’s past achievements in poverty reduction through the existing portfolio. New interventions will aim to strengthen the investment climate to spur private sector growth and job creation and to facilitate regional

connectivity so landlocked Bhutan can reap the benefits of proximity to the vibrant markets of India and Bangladesh. Much of this work will be supported through analytical work and technical assistance. In terms of financing instruments, the CPS will use DPCs to support policy reforms that promote sound fiscal policies and business-friendly regulations and investment loans (including potentially regional IDA resources) to finance trade and transport infrastructure, which is critical for removing impediments to growth and intra-regional trade. Smaller area-specific trust funds will also be used to finance complementary activities, as appropriate.

- **Leveraging WBG resources.** Given the limited resource envelope for Bhutan, the WBG will leverage additional resources—financing and non-financing—to meet Bhutan’s growing needs along three fronts. First, IDA, IFC and MIGA will coordinate closely across the CPS engagement areas and exploit their respective comparative advantage within the Bank Group. IDA will work with the government on policy reforms to create an enabling environment for businesses, as well as tap into regional IDA to finance initiatives with positive regional spillovers. IFC will continue to facilitate private investments, while MIGA will explore opportunities to provide guarantees for investments where appropriate when Bhutan completes the membership process. Second, the WBG will build partnerships with other donors on key programs and selectively raise trusts funds that can contribute to CPS objectives. It will also engage with the government on possible contributions through Reimbursable Advisory Services. Third, the WBG will make full use of its repository of global knowledge to supplement IDA financing with technical assistance and analytical work that will inform and enhance its impact. Given Bhutan’s small size, the country can be an incubator for frontier innovations and the WBG will continue to seek to support such opportunities.

## **Results Area 1: Improving Fiscal and Spending Efficiency**

35. **Under this results area, the WBG aims to help ensure macroeconomic stability as one of the top priorities for Bhutan’s sustainable development.** Bhutan’s large macroeconomic imbalances require strong policy measures to strengthen fiscal and spending efficiency. Hence, WBG efforts will focus on contributing to increased revenues, lower deficits and stronger public financial management and procurement. On the policy front, the World Bank will extend a series of DPCs aimed at strengthening the macroeconomic and fiscal policy framework. On the strategic front, it will support the design of a public finance strategy, aiming to optimize both revenue collection and public spending, including identifying outsourcing opportunities for public services and increasingly relying on demand-side finance for service delivery. On the capacity-building front the WBG will work with the EU and other development partners to strengthen public financial management through the establishment of a Multi-Donor Trust Fund (MDTF) implemented by the Ministry for Finance.

### **Outcome 1: Strengthened Fiscal Efficiency**

36. **The WBG will focus on improving the fiscal policy framework.** The government acknowledges the need to tame consumption expenditure, particularly imports, to sustain the currency peg with the Indian rupee and maintain an appropriate level and composition of external reserves. The CPS addresses the need to increase revenues and reduce the fiscal deficit through a combination of ongoing policy dialogue and program support using the DPC as an

instrument. Fiscal responsibility will supplement the efforts for smoothing consumption by adoption of prudent fiscal rules to manage public finances, with the goal to enforce greater discipline on government spending and reduce the fiscal deficit. In parallel to the DPC, the WBG will continue to provide policy support through various knowledge products, particularly a public finance think piece, which will identify possible saving opportunities, including possibilities for outsourcing activities to the private sector and increasingly relying on demand-side finance for service delivery. A systematic functional review of public expenditures, similar to the 2013 health expenditure review, is also envisaged. The World Bank will also consider further support on taxation, building on previous work by the IMF. Finally, the World Bank may also facilitate, as appropriate, the establishment of a stabilization fund, building on the ongoing fiscal policy dialogue. The goal of the fund would be to protect Bhutan's small economy from potential shocks emanating from the development and commissioning of large hydropower projects, which are almost the size of the country's entire GDP.

37. **Other areas of engagement include the leveraging of public-private partnerships (PPP).** The World Bank will continue to provide technical assistance to help the government to develop a PPP policy and use PPPs to leverage private sector resources for sustainable infrastructure development. The policy dialogue through the DPC series will complement technical assistance to implement the rules and regulations of Bhutan's PPP policy. For example, IFC will support the establishment of a Bhutanese power trading company to enhance the value of hydropower revenues. Engaging the private sector to develop public infrastructure and services through PPP models and divestment will contribute to this effort. IFC's PPP advisory assistance will facilitate potential PPPs in infrastructure and social service delivery, which will support private sector development and create fiscal space for public goods and addressing market failures.

## **Outcome 2: Strengthened Systems for Public Financial Management and Procurement**

38. **The WBG will support efforts to strengthen public financial management (PFM) and procurement to align country systems to international standards.** The World Bank is already using government systems for financial management and for all procurement up to international competitive bidding thresholds. Further efforts are also needed to improve oversight of public sector entities, funding predictability, the quality and timeliness of budget reports and financial statements, implementation of auditing and accounting standards, PFM information systems, availability of professionally qualified staff and effectiveness of internal audits, and on improving procurement efficiency (e-procurement).

39. **The WBG will also focus on strengthening the institutional framework and systems to improve the quality of public spending.** To take the PFM agenda forward, a national level apex committee—the PFM Governance Group (PFM-GG)—has been formed to provide oversight, guidance, revision and monitoring of the implementation of the government's PFM reform action plan. Ongoing PFM technical assistance supports setting-up and operationalizing the PFM-GG, supporting implementation, the review of existing planning, budgeting, revenue and expenditure management systems, training of public accountants, and strengthening of internal audit functions. As the next step, the WBG will continue to support this agenda through the planned PFM MDTF, focused on strengthening: (i) fiscal management and budget formulation; (ii) accounting and reporting systems; (iii) public procurement through automation ensuring economy, efficiency and enhanced transparency; and (iv) accountability institutions.

The MDTF will provide a common platform for donor support to the government's PFM action plan. A PEFA assessment will also be conducted to assess the progress over the last five years and to sharpen the focus of the action plan.

## **Results Area 2: Increasing Private Sector Growth and Competitiveness**

40. **Under this results area, the WBG will promote investment climate reforms—with a focus on the regulatory business framework and access to financial services—with the ultimate goal to increase private investment and promote growth and job creation.** The WBG's support will help create an improved environment for private firms which are the engine to create jobs, supply goods and services, and provide tax revenues. The WBG will therefore support policies and interventions aimed at improving business regulations and policies, strengthening financial systems, and improving access to financial services.

### **Outcome 3: Improved Business Environment**

41. **The WBG will support the government's efforts to improve the business environment.** As mentioned above, the government has committed to improving the regulatory environment and placing Bhutan among the top 100 countries in the WBG's *Doing Business* report rankings (which will depend on Bhutan's performance vis-à-vis other countries). Regulatory reforms must also be accompanied by a review of other private sector investment constraints—including for example access to infrastructure, skills and education—to support private sector-led economic growth. A 2013 investment climate reform memorandum outlines regulatory and legislative reforms to strengthen the business environment, including but not limited to the ones captured by *Doing Business*. During the CPS period, the DPC series along with technical assistance will support several ongoing and future policy reforms to strengthen the legal and regulatory framework that will simplify business procedures—*inter alia* by reducing the number of days required to start a business—promote fair competition and increase private investment. Key reforms include the Companies Act, the PPP policy, the Enterprise Registration Bill, business licensing policy, FDI policy and mining policy.

42. **Implementing these reforms will help spur the growth of private firms, enhance FDI and create jobs.** The implementation of the licensing policy will encourage businesses to participate in the formal economy, leading to better access to credit and expansion opportunities. The policy dialogue through the DPC series and IFC's ongoing advisory services will help adopt the revised FDI policy and lower investment thresholds. The policy dialogue will also support the establishment of a public-private dialogue mechanism to foster dialogue between the government and existing and potential investors. As a result of these measures, in combination with IFC's efforts to catalyze private sector investment, FDI is expected to increase significantly, especially in priority sectors (agribusiness, tourism, and energy-intensive industry such as mining).

43. **In addition to advisory assistance, IFC will continue to explore direct and indirect investments to Bhutanese companies.** Along with the hydropower sector support noted earlier, IFC will build on its business development efforts to facilitate private investments, especially in agriculture and tourism. As in the case of IFC's Bhutan National Bank (BNB) investment, IFC-supported projects are required to meet international practice standards, often higher than those

currently adopted in Bhutan, thereby positively influencing market standards while providing an international stamp of approval to supported projects and companies.

44. **To complement efforts to improve the business environment, the WBG will undertake analytical work to enhance the understanding of Bhutan's labor market dynamics and social protection.** The government recognizes that the lack of safety nets, particularly for workers outside the public sector, leaves the population vulnerable. It also leads to a bias among young job seekers who pursue the limited opportunities in the public sector to secure better benefits. In order to increase the attractiveness of private sector jobs, it will be necessary to rebalance these benefits. To this end, the WB will provide technical assistance in the design of a social protection strategy and the implementation of a safety net scheme for the most vulnerable. In addition, an in-depth study of the labor market dynamic and skills will examine the rising youth unemployment, labor mismatch, and bias towards the public sector.

45. **The WBG will also seek to expand Bhutan's trade prospects through financing for critical regional connectivity infrastructure.** Road transport in Bhutan accounts for more than 90 percent of trade traffic by volume and value, but movement is often interrupted by landslides and delays, particularly during monsoon season. In addition, poor connectivity along the southern border with India makes domestic movement difficult and expensive. The absence of a complete Southern East-West Highway means Bhutan's traffic has to pass through Indian territory in moving from one part of the country to another, imposing costly delays at the borders. Transport connectivity, economic corridor development and trade facilitation measures are therefore important priorities under the government's 11<sup>th</sup> Five Year Plan. An IDA regional connectivity project to facilitate regional trade will respond to the 2014 poverty assessment, which identifies road connectivity (domestic and regional) as a key driver of poverty reduction and shared prosperity. The proposed project will include financing for road infrastructure, trade infrastructure, support for feasible inland waterways and measures that will facilitate Bhutan's international trade, especially with India and Bangladesh.

#### **Outcome 4: Increased Efficiency and Access to Financial Services**

46. **The WBG will provide comprehensive support to implement a sound policy framework of the financial system, with a focus on increasing access to financial services.** The WBG has been supporting the government in key financial sector reform, including the issuance of additional banking and insurance licenses, the amendment of the Royal Monetary Authority (RMA) and Financial Services Acts and the development of a financial sector strategy. A combination of policy dialogue under the DPC and technical assistance for the implementation of the Financial Sector Strategy will continue during the CPS period. Implementation of the strategy will pave the way for a more inclusive financial sector in Bhutan. In addition, the WBG will explore funding through the FIRST initiative to support implementation of the Financial Sector Development Implementation Plan (FSDIP). The implementation of several policy reforms like a movable collateral act, a collateral registry, a credit information bureau and registering property and resolving insolvency will aim at increasing access to finance. In parallel, IFC will continue to work with the RMA in developing a corporate governance program to benefit financial institutions and listed companies. Complementing the system-wide support, IFC will support BNB with improving its risk management capabilities to better serve small and medium enterprises.

### Results Area 3: Supporting Green Development

47. **Under this results area, the WBG aims to contribute to Bhutan’s goal of achieving green and inclusive growth.** The country’s large stock of natural capital calls for increasing its sustainable contribution to the economy, while protecting the environment and human well-being.<sup>12</sup> Bhutan’s current Economic Development Policy incorporates several aspects of a green growth agenda, including: (i) a continued focus on hydroelectricity, forestry, high-end/low-impact tourism, and agriculture as strategic sectors; (ii) a move towards banning agro-chemicals, and promoting export-oriented organic agricultural product; (iii) the promotion of environmentally friendly businesses and FDI; and (iv) making Bhutan carbon neutral. To achieve these objectives, Bhutan faces several challenges including: rapid urbanization, losses of agricultural land and low productivity, infrastructure deficit, complications in maintaining supply chains given its topography, changes to hydrology in the Himalayas as a result of climate change, among others.

#### Outcome 5: Increased Agriculture Productivity in Targeted Remote Areas

48. **The WBG will continue efforts to boost agricultural productivity and rural livelihoods in remote areas in Bhutan where incidence of poverty is high.** As noted above, commercialization of agriculture has been a main driver of poverty reduction. Sharp increases in exports of commercial crops (oranges, cardamom, potatoes and apples), combined with better access to markets, fostered pro-poor growth. Through an ongoing IDA operation, the Remote Rural Communities Development Project, WBG will continue to promote improved irrigation and agronomic practices and rehabilitation of productive assets for key commodities. The project—which has mainstreamed gender in the planning and implementation of the community infrastructure investments and agriculture technology—will particularly focus on benefitting the female labor force. In addition, community-led investment will improve access of the poorest people (particularly women) to critical and missing infrastructure needs in select areas. IFC will also continue to seek opportunities to promote agribusiness. On the knowledge side, the CPS will explore opportunities and resources to complement ongoing food security programs, including their impact on malnutrition, pilot youth employment initiatives and engage in PPPs where possible.

#### Outcome 6: Improved Urban Infrastructure Management

49. **The WBG will continue to help improve urban infrastructure management through support for the 11<sup>th</sup> FYP’s urbanization policies.** This may involve: (i) the development and implementation of human settlements strategy, (ii) the establishment of an institutional and legal framework to enable effective human settlement planning at the national level, and (iii) the application of traditional Bhutanese architectural guidelines and heritage-sensitive urban development planning. Under the Second Urban Development project, WBG will continue to support improved urban planning and infrastructure provision in Thimphu. Capacity-building will be expanded to include two additional *Thromdes* or city corporations to promote more efficient, transparent and financially sustainable local governments. Basic infrastructure

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<sup>12</sup> Natural capital refers to the stock of natural resources that provide flows of valuable goods and services. Major types of natural capital include agricultural lands; subsoil assets (oil, gas, coal, and minerals); forests; water; fisheries; and the atmosphere.



services such as roads, water supply, and sewage will be targeted for improvement in northern Thimphu.

50. **In addition, the WBG will support green transportation in Thimphu, encompassing electric vehicles, public transport and pedestrian transport.** This support builds in particular on IFC's Bhutan Urban Transit System advisory.<sup>13</sup> IFC will explore additional PPP support in infrastructure which would benefit urban space through effective service delivery.

### **Outcome 7: Improved Management of the Natural capital and Strengthened Resilience to Climate Change/Disaster Risks**

51. **Bhutan is highly prone to natural hazards including floods, landslides, cloudbursts, windstorms, river erosion, earthquakes and tropical cyclones.** In 2009, cyclone Aila caused damages of approximately \$17 million due to destruction of farmland and infrastructure. However, at present, Bhutan does not have the capacity to issue reliable weather or flood forecasts or to monitor climate trends or assess the impact of climate change on hydropower and agriculture. Improving lead time for forecasting is critical for disaster preparedness, as it enables communities to be better prepared to respond to such hazards. Equally, disaster management agencies would benefit from stronger capacity to support local communities' preparedness and response to both seismic and water-related hazards. Strengthening disaster management and climate resilience are key government priorities and the WBG will continue its engagement on disaster risk and climate change management.

52. **Finally, the WBG will remain engaged in helping Bhutan manage its natural capital to enhance its contribution to development in a sustainable way.** It will continue its ongoing engagement in sustainable mining. It will support the revision of policy and regulatory frameworks, and share international experiences. In addition, a variety of instruments will support wildlife conservation, carbon-trading and sustainable management of forests. The latter will support national capacity to engage in international Reduced Emissions from Deforestation and Forest Degradation (REDD+) efforts through strengthened policies, increased knowledge and enhanced data on forests and forest management. The GEF-funded Sustainable Financing for Biodiversity Conservation and Natural Resources Management Project supports the effectiveness and sustainability of the Bhutan Trust Fund for Environmental Conservation (BT FEC), including protected areas.

53. **The WBG will remain engaged in sustainable tourism development, an integral aspect of government efforts to foster balanced and sustainable development.** The Bank will provide advisory and technical support geared towards assisting the government in implementing the new Heritage Sites Bill. It will also pilot new approaches to the rehabilitation and promotion of heritage villages and traditional houses in cities within regional development and youth employment framework. The IFC is pursuing opportunities to assist the government's efforts in promoting year-round tourism and tourism in more remote parts of the country. IFC, which invested in Aman Resort in 2003, also looks forward to partnering with other development partners in the field of tourism, particularly with the Government of Austria.

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<sup>13</sup> The project was not implemented due to a funding gap.

54. **The WBG will remain open to engaging hydropower development especially in the regional context, leveraging its global experience in complex hydropower projects.** Hydropower development in Bhutan merits special attention. Beyond its central contribution to domestic development, it is also a regional good. Given the regional energy deficit, Bhutan can play a key role in catalyzing regional cooperation to further develop clean hydropower capacity for the benefit of the region. Many of Bhutan's hydropower projects have traditionally benefited from soft financial assistance from the Government of India. Going forward, as different financing models are explored, the WBG can play a significant role by potentially tapping into IBRD enclave financing, IFC's own financing and resource mobilization capabilities.

55. **Institutional and human resource capacity building as well as gender will continue to be addressed in the Bhutan program in a cross-cutting manner.** Support for capacity building will be provided through policy dialogue, analytical work and technical assistance. Gender will be mainstreamed in all of WBG operations and gender statistics will be reviewed for accountability, timeliness and reliability.

### **C. Implementing the CPS**

#### *Planned non-Lending*

56. **The knowledge program under this CPS will focus on the areas where the WBG has comparative advantages.** During the last CPS period, the WBG delivered a demand-driven knowledge program which raised awareness on critical issues such as health, nutrition and gender and provided policy and implementation advice through public expenditure review in health and education sectors, among others. Going forward, analytic work will be divided into supporting the CPS results areas, and building the knowledge base to strengthen policies and institutions (see Table 2). Future engagement will draw from global knowledge and existing work to explore opportunities in: (i) partnerships with local and international research institutions, (ii) public debates in key areas critical to Bhutan's growth; (iii) working closely with government to develop workshops and seminars on key topics to enhance dissemination of innovative approaches, and (iv) creating linkages between sector analytical work and operations to complement policy dialogue and improve results.

57. **Conversely, the WBG will proactively facilitate the sharing of knowledge and lessons that Bhutan can bring to the world.** Examples include Bhutan's experience and record in multi-dimensional poverty and welfare measurement, poverty alleviation, public governance, environmental protection, and green growth (including tourism and hydropower), among others. Table 2 presents an indicative program of non-lending (analytical and technical assistance) activities for the first 3 years of the CPS. The program for the outer years will be articulated in the mid-term review of the CPS.

**Table 2: Indicative Non-lending Program**

FY15	FY16	FY17
<b>Analytical Work</b>		
Bi-annual economic updates		
Public Finance Think Piece		PER
PEFA Update		
Labor market & skills Assessment		
	Investment Climate Assessment	
<b>Technical Assistance (Grants/Trust Funds)</b>		
Public Finance Management MDTF		
Statistical Capacity Building - TFSCB		
PPP TA (PPIAF) (WB + IFC)		
Financial Sector (FIRST)		
BNB Risk Management Advisory (IFC)		
Corporate Governance RMA (IFC)		
Business Climate TA (WB+IFC)		
Rural Youth Employment (JSDF)		
Social Protection TA		
Inland Water Transport		
Feasibility SEW Highway/ICD		
Cultural Heritage TA		
REDD+ Grant (FCPF)		
Disaster and Climate Resilience TA		
Green Urban Transport		
	Green growth TA (including Mining)	
Tourism Strategy (IFC)		

*Planned Financing*

58. **Bhutan's indicative IDA allocation during IDA17 (FY15-17) is Special Drawing Rights (SDR) 36.9 million (about \$57 million).** The final allocation for FY15 is SDR12.6 million (about \$19.4 million). With a per capita income of \$2,400, Bhutan is already a low middle-income country and given its high growth potential will likely move progressively toward graduating from IDA and accessing IBRD resources, if it so chooses. IBRD will assess Bhutan's eligibility at the mid-point of this CPS and in the event that Bhutan becomes eligible, the CPS program will be adjusted to take advantage of this opportunity. Table 3 provides an overview of the planned financing program.

**Table 3: Indicative Financing Program**

FY15	FY16	FY17	FY18	FY19
<b>IDA Lending</b>				
Development Policy Credit (\$20 m)	Regional Connectivity Project* (\$13 m)	Development Policy Credit (\$20 m)	Regional Connectivity Project* (\$13 m)	Development Policy Credit (\$20)
<b>Possible IFC Investment</b>				

\* Regional connectivity projects will be considered for additional IDA financing for the components that will have clear regional spillovers if funds from other sources will not be identified.

*Ongoing WBG Program*

59. **Bhutan has a small but active WBG program with four IDA/GEF operations under implementation.** They include: (i) the Decentralized Rural Development Project, (ii) Urban

Development II Project, (iii) Remote Rural Community Development Project, and (iv) Sustainable Financing for Biodiversity (GEF) - with a total commitment of \$33.9 million of IDA and Trust Fund resources. Bhutan is a small participant in a regional IDA wildlife project in addition to about 10 other trust-funded operations including grants on disaster risk management, corporate governance, public financial management, urban budget processes, green growth and social protection. Additional financing for Urban Development II was approved by the Board in May 2014 for a total of \$17.4 million.

**60. Portfolio performance is satisfactory, with no problem projects or implementation issues.** The disbursement ratio in FY14 was 38.3 percent for IDA and 61 percent for trust funds—the highest in the region and above Bank averages. Significant progress has been made in the enhanced use of country systems and moving towards a programmatic approach in portfolio management.

**61. The Bank provides significant analytical work and technical assistance.** Recent analytical work includes a Gender Policy Note, a Nutrition Assessment, a Poverty and Social Impact Analysis of the proposed Bill on Cultural Heritage, contributions to the IMF Financial Surveillance report and Article IV, a Debt Sustainability Assessment, a Human Development Public Expenditure Review, a review of higher education, and an Investment Climate Assessment which served to support the recent DPC and to improve the policy framework governing private sector development. A Poverty Assessment and a Green Growth study were also completed. Ongoing TA includes support to the design of a Financial Sector Strategy, green transportation and electric vehicles, debt management and sustainability, *Doing Business* (jointly with IFC), and PPPs. The WBG also provided just-in-time knowledge pieces, including sector policy notes for the new government, seminars with government, private sector, CSOs, parliamentarians and academia.

**62. As of April 2014, IFC's portfolio stood at \$32 million,** including an equity participation in BNB, trade finance support, and a loan for the Aman Resort. The advisory portfolio includes structuring PPPs, improving Bhutan's investment climate and enhancing access to financial services. IFC continues to explore areas of assistance in hydropower, tourism, manufacturing, agribusiness, health and education sectors. IFC's advisory support on investment climate reforms, PPP development and the financial sector strengthening is expected to continue.

**63. In January 2013, Bhutan took the first step to becoming a member of MIGA by signing the MIGA Convention.** The Convention has been ratified by the National Assembly and the National Council. Bhutan is currently in the process of completing other requirements for membership. Upon completion of the membership process, MIGA will be able to support investments in Bhutan by providing guarantees.

#### *Donor Coordination*

**64. Donors maintain an active presence in Bhutan and the Bank will explore partnerships in common areas of engagement to maximize impact and avoid aid fragmentation** The government in partnership with UNDP hosted the 12th Round Table

Meeting (RTM) in December 2013.<sup>14</sup> The RTM since its inception in the early 1980s is the highest level donor coordination forum with government. The meeting provided an opportunity to ensure better alignment of international development assistance with the national priorities for improved aid-effectiveness. Table 4 shows Bhutan’s main donors, engagement areas and areas of cooperation with the WBG.

**Table 4: Donor Engagement in Bhutan**

<b>Development Partner</b>	<b>Engagement Area</b>	<b>Areas of cooperation with WBG</b>
<b>Asian Development Bank (ADB)</b> <ul style="list-style-type: none"> <li>• Largest multilateral donor</li> </ul>	<ul style="list-style-type: none"> <li>• Energy</li> <li>• Transport</li> <li>• Public sector</li> <li>• Finance</li> <li>• Urban and rural development</li> <li>• Regional (energy and transport)</li> </ul>	<ul style="list-style-type: none"> <li>• Financial sector development</li> <li>• Investment climate (co-financing of the Better Business Summit)</li> <li>• Urban development</li> <li>• Regional connectivity (planned IDA regional project will complement ADB activities)</li> <li>• Joint Technical Assistance on the Green transportation and Electric Vehicle Initiative (also with UNDP).</li> </ul>
<b>Austria</b>	<ul style="list-style-type: none"> <li>• Energy</li> <li>• Tourism</li> <li>• Governance</li> </ul>	<ul style="list-style-type: none"> <li>• Showing interest in planned PFM Multi-Donor Trust Fund (with EU)</li> </ul>
<b>European Union (EU)</b> <ul style="list-style-type: none"> <li>• Tripled its funding for Bhutan to €42 million over seven years (2014-2020)</li> </ul>	<ul style="list-style-type: none"> <li>• Local governance (decentralization)</li> <li>• Civil society organizations</li> <li>• Public finance management</li> <li>• Sustainable agriculture and forestry (budget support)</li> </ul>	<ul style="list-style-type: none"> <li>• Planned establishment of a PFM Multi-Donor Trust Fund</li> </ul>
<b>India</b> <ul style="list-style-type: none"> <li>• Largest donor</li> <li>• Committed to provide INR45b to the implementation of the 11<sup>th</sup> FYP (\$750m, or \$150m/year)</li> </ul>	Supporting FYPs financing across the board, including, but not exclusively: <ul style="list-style-type: none"> <li>• Energy/Hydropower</li> <li>• Transport infrastructure</li> <li>• Education and culture</li> </ul>	
<b>Japan International Cooperation Agency (JICA)</b> <ul style="list-style-type: none"> <li>• Bhutan’s first DAC bilateral donor</li> <li>• Large program of volunteers throughout the country</li> </ul>	<ul style="list-style-type: none"> <li>• Agricultural and rural village development</li> <li>• Economic infrastructure development</li> <li>• Social development</li> <li>• Governance</li> </ul>	<ul style="list-style-type: none"> <li>• Collaboration on disaster risk management</li> <li>• Use of Japanese Trust-Funds</li> </ul>
<b>Netherlands (SNV)</b>	<ul style="list-style-type: none"> <li>• Rural development (water, renewable energy, agriculture)</li> <li>• Capacity building</li> </ul>	
<b>Swiss Development Corporation (SDC)</b>	<ul style="list-style-type: none"> <li>• Local governance</li> <li>• Democracy</li> <li>• Rural development</li> </ul>	
<b>UN Program</b> <ul style="list-style-type: none"> <li>• UNDP leads donor coordination</li> </ul>	<ul style="list-style-type: none"> <li>• Governance</li> <li>• Creating an enabling environment for poverty alleviation</li> <li>• Mainstreaming of the MDGs and poverty reduction in the FYP</li> </ul>	<ul style="list-style-type: none"> <li>• Joint Technical Assistance on the Green Transportation and Electric Vehicle Initiative (also with ADB)</li> </ul>

<sup>14</sup> According to the UN classification, Bhutan is a Least Developed Country (LDC) and is expected to graduate in the early 2020s.

UN Program (cont.)	<ul style="list-style-type: none"> <li>• Health (World Health Organization; WHO)</li> <li>• Education (United Nations Children's Fund; UNICEF)</li> </ul>	<ul style="list-style-type: none"> <li>• Collaboration with WHO and UNICEF on nutrition/stunting issues, including an assessment of malnutrition and stunting in Bhutan in 2013</li> <li>• Support to Ministry of Health to prepare a Nutrition Implementation Strategy</li> </ul>
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### Monitoring of Results

65. **Implementation of the CPS will be monitored through a results matrix (Annex 2).** The results matrix takes into consideration the lessons learned from the implementation of the previous CPS. The results matrix represents the priority outcomes of the WBG in Bhutan, which are aligned with the objectives of Bhutan's 11<sup>th</sup> FYP and the WBG's ongoing and indicative program. Monitoring of the CPS indicators results will be linked with the annual portfolio review, conducted jointly with government. Greater efforts will be made for conducting multi-sector dialogue for each outcome and ensuring adequate coordination and real time monitoring of progress. A review at mid-term will make any necessary adjustments to the results framework.

## V. MANAGING RISKS

66. **As in any country engagement, the Bank Group's program in Bhutan faces risks that could pose implementation delays and impact the achievement of CPS objectives.** The most significant risks could emerge potentially from political resistance to reforms, macroeconomic imbalance stemming from internal and external factors, weak local implementation capacity and vulnerability to natural disasters and climate change. These risks and the proposed mitigation measures are described in detail in Table 5.

**Table 5: WBG Engagement Risks and Mitigation Measures**

Risks	Mitigation measures in the CPS program
<b>Political Risks</b>	
While political will at the highest level is strong, lack of inter-agency coordination could constrain reforms. Fiscal restraint might face resistance from politicians, which is likely to increase closer to elections in 2018.	The DPC operation is timed at the beginning of the five-year political cycle) to allow sufficient time to build consensus for reforms. In addition, the WBG will continue to engage actively with Bhutan's political leadership and key counterparts to address any emerging concerns.
<b>Macroeconomic Risks</b>	
Bhutan's concentrated export base, rupee-reserves mismatch with external debt and the trade structure of the country leave it vulnerable to exports and any shortfalls in aid inflows. Additional risks stem from bulky hydro-related debt service payments, which require provisioning of rupee reserves.  Aggregate demand pressures could re-emerge and lead to another episode of rupee shortage, following the lift of bans on imports and foreign exchange restrictions combined with the increase in civil servant salaries and allowances effective July 1, 2014.	Hydropower projects bring strong economic dividends in the long term by boosting average real GDP growth and exports. Bhutan's strong track record of project implementation in this sector, the commercial viability of the new hydropower projects, the close economic and political ties with India mitigate the commercial risks of these projects. Moreover, much of the debt is self-liquidating in nature, since debt servicing is linked to the generation of future hydropower revenues. Continued power shortages in India (or other countries in the region) will likely ensure strong electricity demand.  Government is taking action to address macroeconomic risks, by curbing credit growth and fiscal consolidation, actions which are supported by the proposed DPC series. Mitigating factors include the proposed monetary and fiscal tightening under the DPC program, including taxation measures.

Rapid credit growth in recent years has increased financial sector vulnerabilities.	Mitigating factors include actions to adjust prudential regulations and norms to help curb large exposures to some sectors.
<b>Implementation Risks</b>	
Implementation capacity remains highly constrained and calls for provision of appropriate technical assistance to support government in reform implementation. Fraud and corruption, even though limited so far, could impact the program.	Program design accounts for capacity constraints through selectivity and mainstreaming capacity building activities. It will also seek to leverage technical assistance resources. Other mitigating factors include Bhutan's strong project implementation record and good governance. A strong focus on project preparation will continue, with improved use of readiness filters. The Bank will also continue to encourage early project restructuring, if the circumstances demand it. Infrastructure activities are accompanied by additional attention to safeguards during preparation and implementation support. These include capacity-building support in carrying-out environmental and social impact assessments, as well as training and study tour program for key officials involved in safeguard related work.
<b>Risks from Natural Disasters and Climate Change</b>	
Bhutan's rugged topography, geographic and climatic features make it prone to natural disasters such as earthquakes, floods, landslides, wind storms, as well as both man-made and natural fire disasters. Over the past 40 years, several earthquakes above a magnitude of 6 on the Richter scale have occurred. According to the World Bank report on Natural Disaster Hotspots (2005), 31.3 percent of Bhutan is in risk areas, and 60.8 percent of its population is at high mortality risk from multiple hazards. The frequency and intensity of extreme weather events appears to be increasing. The country has become increasingly vulnerable to hydro-meteorological related disasters which may be an effect of climate change.	Strengthening disaster management and climate resilience are key government priorities, which introduced a comprehensive legal framework for disaster management in 2013. During this CPS period (2014-2019), the WBG, through a variety of instruments will seek to support Bhutan's objective of strengthening green growth while managing environmental, natural disaster and climate related risks. These include one regional IDA project on wildlife conservation, several trust-funds such as the REED+ Grant for forest management, PHRD grant for seismic resilience, technical assistance activities relating to hydromet modernization, disaster management and climate services and follow up lending, and possibly WAVES trust funds.. The ongoing TA on hydromet modernization is helping prepare a roadmap for modernizing hydromet and climate services in Bhutan.





### Annex 1: Bhutan CPS Results Matrix

RGoB's Objectives (11 <sup>th</sup> Five year plan)	Issues and Obstacles	CPS Outcomes and Indicators Targets=FY19 unless specified	Indicative Milestones	World Bank Group Program (Ongoing and Indicative)
<b>Results Area 1: Improving Fiscal and Spending Efficiency</b>				
Sustained economic growth and macroeconomic sustainability	Current account deficit with increased aggregate demand/fiscal expansion Unsterilized inflows leading to credit expansion Lack of fiscal incentives to invest, diversify, and contain consumption	<b>Outcome 1: Strengthened fiscal efficiency</b> <b>Indicator 1:</b> <u>Ratio of domestic revenues to total expenditure</u> Baseline: 65 percent (FY2013) Target: 85 percent (FY2019)  <b>Indicator 2:</b> <u>Fiscal deficit</u> Baseline: below 5 percent (FY2013) Target: below 3 percent (FY2019)	- Fiscal rules adopted for managing public finance - Power trading company established - PPP policy approved and PPPs identified	<b>Ongoing Operation:</b> DPC <b>Indicative operations:</b> DPC, PFM MDTF, support for power trading company (IFC) <b>Ongoing AAA/TA/Advisory:</b> Public finance think piece, DSA <b>Indicative AAA/TA/Advisory:</b> Public finance TA, DSA, DEMPA TA. Possible PPP support (IFC), Statistical Capacity Building
Strengthened efficiency and effectiveness in governance/efficient public service delivery	Systems are not integrated Limited availability of qualified accounting and auditing professionals Quality and timeliness of financial reporting are inefficient	<b>Outcome 2: Strengthened systems for public financial management and procurement</b> <b>Indicator 3:</b> <u>PEFA</u> PI-9. Oversight of aggregate fiscal risk from other public sector entities D+ (2010) to C+ (2019); PI-24. Quality and timeliness of in-year budget reports D+ (2010) to C+ (2019); PI-27 Legislative scrutiny of the annual budget law D+ (2010) to C+ (2019)  <b>Indicator 4:</b> <u>Procurement time</u> Baseline: 110 days (2010), Target: 65 days (2019)	- PFM strategy and PFM committee in place - e-procurement core module in place - Professional Accountancy Organization established	<b>Ongoing Operations:</b> DPC, PFM IDF <b>Indicative Operations:</b> DPC, PFM MDTF <b>Ongoing AAA/TA/Advisory:</b> update of PEFA, Public finance think piece (PER), Statistical Capacity Building
<b>Results Area 2: Increasing Private Sector Growth and Competitiveness</b>				
Strengthening policy and regulatory framework to improve and simplify business	High regulatory, administrative and policy costs on businesses High connectivity costs	<b>Outcome 3: Improved business environment</b> <b>Indicator 5:</b> <u>Number of days to start a business</u> Baseline: 32 days (2014), Target: 7 days (2019) <b>Indicator 6:</b> <u>Foreign direct private investment</u> Baseline: \$21 million (2014), Target: \$50 million (2019)	- Implementation of enterprise registration bill - Online registration of companies operational - FDI policy revised - Telecom policy adopted - Licensing policy adopted - Social protection strategy adopted	<b>Ongoing Operation:</b> DPC, Aman Resort investment (IFC) <b>Indicative Operation:</b> DPC series, Regional connectivity project, possible IFC real sector investments <b>Ongoing AAA/TA/Advisory:</b> Doing Business TA (WB+IFC) Public-private dialogue, PPP TA (PPIAF), Social protection TA

				<b>Planned AAA/TA/Advisory:</b> Investment climate assessment (IFC+WB); Inland water transport, tourism strategy (IFC)
Facilitate access to finance	Limited access to financial services for SMEs Lack of financial sector strategy Complex financial regulations to acquire loan	<b>Outcome 4: Increased efficiency and access to financial services</b>  <b>Indicator 7:</b> Increase in the share of <u>credit to manufacturing, agriculture, service and tourism, trade and commerce</u> Baseline (2013): 45% Target: 50% (2019)  <b>Indicator 8:</b> Increased coverage of <u>Credit Information Bureau</u> : Baseline: 0% (2014); Target: 50% (2019) existing loans covered	- A comprehensive Financial Sector Development Implementation Plan (FSDIP) developed and approved -Improved regulatory framework for CIB -% of all movable collateral backed loans registered - BNB risk management framework operational	<b>Ongoing Operation:</b> DPC, BNB investment (IFC), Global Trade Finance Program (IFC) <b>Planned Operation:</b> DPC Series, possible SME fund (IFC) <b>Ongoing AAA/TA/Advisory:</b> Financial sector strategy TA (FIRST TF), BNB (IFC) <b>Planned AAA/TA/Advisory:</b> Implementation Financial sector Strategy (FIRST TF), Corporate Governance RMA (IFC)
<b>Results Area 3: Supporting Green Development</b>				
Accelerate and sustain RNR sector growth	Lack of irrigation Limited access to markets Labor shortage (rural-urban migration) Subsistence/small scale farming Limited/loss of agricultural land (due to sloping terrain and urban development) Lack of access to credit Human-wildlife conflict Animal damage	<b>Outcome 5: Increased agricultural productivity in targeted remote areas</b> <b>Indicator 9:</b> Cereal yields in targeted <u>irrigation system (tons/hectare)</u> <i>Paddy</i> : Baseline: 2.20 (2012); Target: 2.60 (2017). <i>Maize</i> : Baseline: 1.70 (2012); Target: 2 (2017)  <b>Indicator 10:</b> Number of female clients <u>who adopt an improved agriculture technology</u> Baseline: 0 (2012); Target: 190 (2017)	- Area provided with irrigation and drainage services – New (ha) Baseline: 0 (2012) Target: 60 (2017) - Community participatory consultations completed and all sub-projects (rural infrastructure) activities identified and selected by communities in targeted districts	<b>Ongoing Operations:</b> Remote Rural Community Project <b>Ongoing AAA/TA/Advisory</b> Green growth policy note, Labor market study <b>Planned AAA/TA/Advisory:</b> JSDF “Youth led enterprises”, Poverty Assessment
Ensure balanced and sustainable development of human settlements	Rural-urban migration Limited urban planning/management capacity	<b>Outcome 6: Improved urban infrastructure management</b>  <b>Indicator 12:</b> Number of new <u>households with piped water and sewage connections and kilometers of internal roads constructed in the targeted cities</u> Water: Baseline: 20,000 (2010); Target: 20,850 (2019);	- Human settlements strategy in place - Number of buildings with new traditional architectural guidelines - Cultural heritage site bill approved and implementation started - Number of beneficiaries	<b>Ongoing Operations:</b> Second Urban Development Project and Additional Financing, Strengthening intergovernmental systems IDF <b>Ongoing AAA/TA/Advisory</b> Thimphu parking PPP (IFC), Green growth policy note, Green Urban Transport TA, Implementing the Cultural Heritage Site Bill TA;

		<p>Sewage: Baseline: 0 (2010); Target: 850 (2019)  Roads: Baseline: 0km (2010); Target: 8.34km (2019)</p> <p><b>Indicator 13: Upgraded municipal finance systems in four city corporations</b>  <u>Building permits for service plots</u>  Baseline: 115 (2010); Target: 250 (2019)</p>	<p>from green transport initiatives increased (to be confirmed)</p>	<p>Poverty Assessment</p>
<p>Conservation and sustainable utilization of environment</p>	<p>Climate change impact  Natural disaster prone region  Limited capacity for conservation and monitoring climate change and variability impact</p>	<p><b>Outcome 7: Improved management of the natural capital and resilience to climate change/disaster risks</b></p> <p><b>Indicator 14: Areas under protected area management (ha)</b>  Baseline: Zero (2013); Target: 900,00 ha (2018)</p> <p><b>Indicator 15: Improved disaster preparedness and delivery of weather and climate services</b>  Baseline: 1 day subjective weather forecasting (2014); Target: 3 day weather forecasting with verification system (2019)</p>	<p>- M&amp;E system that effectively monitors conservation investments  - Roadmap for hydromet Modernization prepared  - Updated guidelines for building vulnerability implemented  - Forest inventory completed and forest monitoring data management system established  - Number of engineers trained for seismic vulnerability assessment and retrofitting  Baseline: 0 (2014); Target: 50 (2019)</p>	<p><b>Ongoing Operations:</b> Regional Wildlife IDA, GEF BTFEC  <b>Ongoing AAA/TA/Advisory</b> Green growth policy note, PHRD for Improving Resilience to Seismic Risk, GFDRR Improving Disaster Management Capacity, Bhutan hydro met modernization and resilience TA, Sustainable mining TA  <b>Planned AAA/TA/Advisory:</b> Bhutan Regional Climate Services; FCPF Trust Fund, REDD+, WAVES, Disaster and Climate Resilience TA</p>



## Annex 2: Bhutan CPS Completion Report FY11-14

Date of CPS: October 9, 2010

Date of CPS Progress Report: March 8, 2013

Period Covered by the CPS Completion Report: FY 11- FY14

Prepared by: Alema Siddiky

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### I. Introduction and Overall Assessment

1. This Country Partnership Strategy Completion Report (CPS CR) assesses the implementation of the World Bank Group's (WBG) program in Bhutan during the FY11-FY14 period. The report evaluates the effectiveness of the WBG's Strategy in aligning its objectives with Royal Government of Bhutan's (RGoB) long term development goals and measures how expected outcomes were achieved. The CPS CR evaluation is based on the results of the implementation of the Bank financed operations, the role of the IFC investments and advisory activities and the impact of analytical and advisory activities (AAA). The report draws on the CPS Progress Report (CPS PR) and the evaluation of results is based on the updated Results Matrix of the CPS PR.

2. **This self-evaluation rates aggregate progress of the CPS program's performance as laid out in the results matrix as Satisfactory<sup>15</sup>.** Across the broad range of engagement areas, on balance most of the CPS objectives have been achieved in line with expectations. However, in some areas program delivery fell short of the ambitious goals in few areas set out in the CPS. The details are as follows:

- The outcomes under the Private Sector Development Cluster are rated as *Satisfactory*. The majority of the targets of the expected outcomes were mostly achieved and the program is on track to meet the remainder of the targets. Good progress has been made in improving regulatory environment for private sector investment, strengthening institutions in building public private partnerships in the key sectors, promoting financial literacy and awareness and upgrading financial infrastructure to improve access to finance. The Bank's intervention has helped to build in country capacity through the development of first economic zones the Information Technology (IT) Park. The Bank's active policy dialogue through Development Policy lending and Private Sector Development project were the main instruments for the improved results in this area. IFC also extended one of its first equity and largest foreign direct investment<sup>16</sup> in Bhutan to help the Bhutan National Bank (BNB) expand and outreach to small and medium enterprises.
- The achievements under the Employment and Skills Development Cluster are rated as *Satisfactory*. The program mostly achieved the targeted development objectives during the CPS period and majority of the quantitative targets were met. The Bank's program made an exceptional development impact in the areas of skills training. Innovative private sector training approaches led to increase in employment opportunities for the Bhutanese youth in the ICT and other sectors. The increase in employment represents 15 percent of total unemployed Bhutanese and 29 percent of total unemployed youth. This is a substantial impact for a small country like Bhutan. The program has also been successful in changing overall vocational training strategies which were replicated in other sectors of the economy. Institutional capacity was strengthened which lead to a positive outcome in partnership with the private sector to provide trainings to the unemployed youth.
- Performance on the Sustainable Urban Rural Development Cluster is rated as *Moderately Satisfactory*. Majority of the outcomes were mostly achieved or achieved with one exception where the target could not be met. In urban infrastructure progresses have been made and initiatives have been taken further to improve urban infrastructure in water, roads and drainage in

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<sup>15</sup> This report follows guidelines issued jointly by the Operations Policy and Country Services unit and the IEG in November 2013 with respect rating methodology and categories.

<sup>16</sup> IFC's \$28.5 million investment for 20 percent stake in Bhutan National Bank. (BNB)

northern Thimpu local areas. The Bank's program achieved two thirds of its target. The remaining work on completing roads construction, household piped water and sewerage connections are expected to be complete in the upcoming CPS. Some results have been achieved in strengthening local revenue administration and expenditure management systems. The CPS program made exceptional achievements in improving rural livelihoods particularly in irrigation schemes, agricultural extension and access to rural roads. The Bank's initiatives have helped 78<sup>17</sup> percent of the targeted rural communities whose average travel time to these facilities reduced by fifty percent. In addition, significant steps were taken to enhance capacity of the key institutions for mitigation measures for an effective disaster management system.

- **Moderately Satisfactory** progress has been made under the Access to Quality Public Services cluster. The CPS program contributed to improving country systems, specially budgeting, expenditure allocation, as well as monitoring service delivery and procurement. The Bank's analytical support has helped the government to formulate policy and awareness particularly in the area of education, health and nutrition.

3. **The Completion Report rates the overall WBG performance in designing and managing the implementation of the CPS program as Good.** The CPS design was relevant in addressing Government's priorities and country needs though it was perhaps overly ambitious on the AAA compared to WBG resources available. On balance, majority of the objectives identified under the results areas have been mostly achieved however there were few outliers' indicators have been identified. In response to RGoB priorities the WBG exhibited flexibility as identified in the CPS PR. IFC activities were relevant and most of the activities contributed to Results cluster 1 and 2<sup>18</sup>. It is also noteworthy that during this CPS, the WBG established the Country Office and enabled to provide just in time and ongoing economic advice, dialogue and capacity support more easily. The portfolio performance was satisfactory with no problem projects. There are currently 3 ongoing operations and the disbursement ratio is at 38.3 percent, highest compared to the other countries in South Asia. The CPS design reflected the WBG's continued effort to improve policy dialogue through AAA and technical assistance. Given the limited IDA resources and a wide range of country development needs, the WBG effectively leveraged trust fund grant for financing projects, analytical and technical work. The Bank also faced challenges in implementing few program due to capacity constraints, budget constraints and lack of knowledge in the Bank's fiduciary system from the client side. However, overall a sound program of ongoing activities is in place for the next strategy period. The WBG continues to be one of Bhutan's key development partners in delivering results in the key engagement areas.

## II. Progress Towards Achieving Country Level Goals

4. **During the CPS period, Bhutan's growth remained strong at an average annual rate of 8 percent.** However, this strong growth is largely from Rupee borrowing. This has led to Rupee shortages and subsequently to a slowing of credit expansion. The overheating of the economy during 2011-12 has eased recently. Inflation has eased to below double digits; it remains elevated due to price developments in India. The current account deficit remains sizable and manageable due to substantial aid flows, including financial resources from India to finance hydropower. Economic growth is estimated to be at 7.3 percent in 2013 and 10 percent per annum range over the next five years due to the coming on board of large hydropower projects, electricity generation as well as continued robust growth in services. However, current account deficit is projected to widen considerably due to additional hydro power projects. As a result, financing from India and other sources needs to be monitored closely, so that the pressure on overall balance of payments position remains contained.

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<sup>17</sup> From the latest ISR and MTR review.

<sup>18</sup> Contribution to Results Cluster 2 is made through financing and technical assistance to the private sector, which generates employment.

5. **The country has made remarkable progress in reducing poverty.** The analysis of the latest Living Standard Survey 2012 (BLSS) shows that 12 percent of the populations are living below the national poverty line in 2012, having fallen from 23 percent in 2007. According to the US\$1.25/day international poverty line only 4 percent of the population classified as poor in 2010 which declined further to 1.7 percent in 2012. During that time poverty declined to all dzonkhags but proved to be stubborn in two dzonkhags<sup>19</sup>. Most of the poverty reduction occurred in the rural areas with little change in urban poverty rates. Inequality has not changed significantly and poverty reduction appears to be growth driven. Growth in Bhutan has been pro-poor –not only did headcount poverty rate declined, poverty gap also declined for all choices of poverty lines. Prosperity has been widely shared by all income groups<sup>20</sup>.

6. **Bhutan’s progress on social sector indicators has been steady**<sup>21</sup>. Bhutan has already achieved on four goals of MDGs on halving extreme poverty, reaching gender parity in education, ensuring environmental sustainability and reducing maternal mortality by three fourths. In the remaining three goals of universal primary enrollment, halting and reversing the spread of communicable diseases, reducing by third infant and under-5 mortality, Bhutan is on track. Almost 98 percent of the populations have access to improved water sources and 80 percent of household have access to improved sanitation. Significant progress has been made toward gender equality. The ratio of male to female labor force participation in 2010 is as high as 86 percent compared to 77 percent in upper middle income countries. Gender equality in basic education has been largely achieved. The country still has high rate of malnutrition – 33.5 percent of stunting amongst children.

7. **Bhutan’s enabling business policy for investment climate improved.** Several policies and regulations have been carried out to streamline rules and regulations and improve the financial infrastructure. Among these are the business licensing policy, simplification of industry application, public-private partnership policy, the renewable energy policy, micro-small and medium enterprise policy, the consumer protection Act and the enterprise registration Act. The Foreign Direct Investment (FDI) rules have been revised and nineteen new approvals have been granted.

8. **Institutional framework has been strengthened to improve labor market.** The government has taken the initiatives to improve labor and employment policies and regulations, active labor market programs through skills training using public private partnerships and enhanced intermediate services to including labor market information and job counseling.

9. **Access to financial services improved.** The Government made significant investment in improving financial infrastructure in the last few years. The use of electronic payment system is widespread and a fully functional Credit Bureau is now in place. The percentage of adult with loan accounts almost tripled and geographical coverage of bank branches also increased. Banking regulation and supervision also strengthened, with the establishment of the New Royal Monetary Authority (RMA) Act and the Financial Services Act. Temporary restrictions were placed on the growth of financial intermediation due to the Rupee shortage, but these are being gradually eased.

10. **Awareness of disaster risk and other climate related risks has increased.** The government adopted the Disaster Management (DM) Act in 2013 to strengthen an effective disaster management system. A comprehensive National Disaster Risk Management Strategy for Bhutan is under preparation. The rules and regulations of the strategy will support the implementation of the DM Act.

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<sup>19</sup> Pemgatshel and Tsirang.

<sup>20</sup> WB Poverty Assessment Report.

<sup>21</sup> Sources of data are from WB “Gender Policy Note”, Bhutan Labor Force Survey and UNDP.

### III. Evaluation of CPS Program Performance

11. This section evaluates the contribution of the CPS program performance based on a set of specific outcomes laid out in the results framework (Annex 1 A) updated during the CPSPR. During the CPS period, the WBG centered its support in four results cluster that contained 18 outcomes. These outcomes are assessed to be achieved (A), mostly achieved (MA); partly achieved (PA) and not achieved <sup>22</sup>(NA). The main findings are discussed below:

**Table 1: Overview of CPS Program Ratings by Outcomes**

Achievements of CPS Outcomes by Results Area	Performance Ratings <sup>23</sup>
<b>Results Cluster 1: Private Sector Development</b>	<b>S</b>
1. Business Policy/Regulation	Mostly Achieved
2. Public Private Partnerships	Mostly Achieved
3. Financial Inclusion	Mostly Achieved
4. Corporate Governance	Achieved
<b>Results Cluster 2: Employment and Skills Development</b>	<b>S</b>
5. Skill competency curriculum	Mostly Achieved
6. Skills Training Program	Achieved
<b>Results Cluster 3: Sustainable Urban Rural Development</b>	<b>MS</b>
7. Urban Service Access	Mostly Achieved
8. Management of urban municipal services	Partly Achieved
9. Rural Infrastructure	Mostly Achieved
10. Rural community infrastructure– share of beneficiaries	Not Achieved
11. Disaster Risk Management (DRM)Capacity	Achieved
12. Institutional set up for Disaster Risk Management	Achieved
13. Policies and action plan for DRM	Achieved
<b>Results Cluster4: Access to Quality Public Services</b>	<b>MS</b>
14. Allocation of resources in social sector	Achieved
15. Service Delivery Standards	Achieved
16. Strategic Partnership in Higher Education	Not Achieved
17. Quality assurance in higher Education	Partly Achieved
18. Health and Nutrition Awareness	Achieved

#### Results Cluster 1: Private Sector Development

12. The CPS under these results area focused on supporting the RGoB’s efforts to unleash potential for private sector growth. The WBG had the following key priorities: i) improving regulatory environment for increased investment; ii) promoting financial inclusion and improving efficiency of the financial sector; iii) leveraging private sector participation and iv) capacity building on key institutions. A combination of lending (Development Policy Credit (DPC) series, investment lending) non-lending technical assistance and parallel analytical work supported to achieve results under these cluster.

13. **Noteworthy progresses have been made in improving business environment.** The WBG program facilitated government’s agenda for reforming policy and regulatory frameworks for private sector growth. DPC series along with the technical assistance from the IFC complemented the approval of

<sup>22</sup>This report follows guidelines issued jointly by the Operations Policy and Country Services unit and the IEG in November 2013 with respect rating methodology and categories.

<sup>23</sup> A= Achieved; MA: Mostly Achieved; P= Partially Achieved; NA= Not Achieved. HS=Highly Satisfactory; S=Satisfactory; MS= Moderately Satisfactory.



amended FDI rules and regulations. It is estimated that FDI approval process for individual priority license will be significantly reduced by 98 percent. The Bank's investment policy dialogue and Private Sector Development projects facilitated the implementation of the Economic Development Policy (EDP). A number of policies and laws are being formulated to implement EDP including business licensing policy and simplification of industry. The policy dialogue on investment climate and Doing Business Reform technical assistance has helped improve the accuracy of the data in Doing Business Survey particularly for the "getting electricity" indicator where it takes 82 days and 5 procedures to obtain a connection; which is lower than South Asia average. In addition, the number of days to start a business has been reduced from 36 days in 2012 to 32<sup>24</sup> days in 2013 and new regulations improved access to credit information. The Bank's technical assistance<sup>25</sup> helped RGoB draft an investment climate reform memorandum (memo) and provided assistance in the formulation of action plan and institutional set up to drive the reform process. The Bank and IFC will continue to provide technical assistance in the implementation of reforms.

**14. IFC led number of activities that helped to streamline business licenses and improve access to information.** IFC supported Licensing Simplification project has helped to simplified project approval process for medium and large enterprises. Some of the steps included: removal of steps in the approval process, reduced documentary requirement and eliminating cross-ministerial consultations. For the priority sectors<sup>26</sup> the number of days to approve project has been reduced from 213 days to 10.5 days. These improvements are expected to save time to obtain FDI and associated direct and opportunity costs for the private sector. A License Policy for Bhutan has been prepared and submitted to Gross National Happiness Commission for approval. In addition, electronic licensing (G2B) containing a comprehensive inventory of 119 licenses has been launched and active<sup>27</sup> since August 15, 2012. This is a noteworthy milestone in improving information access in Bhutan and expected to reduce the significant information asymmetry that existed. In order to improve information access on the site of the issuing agency, IFC conducted process mapping and analysis for 11 pilot licenses. The communication materials from this exercise have been disseminated and expected to improve information system significantly.

**15. Policy and institutional framework for Public Private Partnership (PPPs) in infrastructure improved.** During the CPS two public private partnerships have been initiated and two third of the CPS target has been achieved. The IT Park is a pilot for PPPs in infrastructure is the first economic zones operated by the private sector and with public/private investments. The Bank through Private Sector Development project and technical assistance supported the Government in drafting a PPP policy for Bhutan and provided a comprehensive institutional framework for PPP. The draft is currently being reviewed by GNH Commission is expected to be approved by FY15. The framework provides security for private sector investment and ensures transparency, competition and regulation awarding PPP projects. The WBG's technical assistance with PPPs helped to increase client capacity through bringing global good practices and basing the drafting process on wider stakeholder. The Bank's active support also facilitated government in attracting PPPs in other sectors like education, training, skills development and entrepreneurship. In parallel, IFC prepared advisory concept notes on potential PPPs that helped the RGoB analyze options and one is under implementation. IFC has been providing advisory services for Thimpu Thromde, the municipality under the PPP model for developing and managing an integrated parking system. A feasibility study was prepared in setting up a Bhutanese Power Trading Company in India which if implemented would help enhance the value of Bhutan's hydropower and would be the first Bhutanese investments outside its borders. The WBG program will continue to support these initiatives through policy dialogue and technical assistance in the next CPS<sup>28</sup>.

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<sup>24</sup> Doing Business Report

<sup>25</sup> Bhutan Doing Business Reforms-TA

<sup>26</sup> As identified in the Govt EDP.

<sup>27</sup> [www.g2b.gov.bt](http://www.g2b.gov.bt)

<sup>28</sup> Approval of PPP rules and regulations will be developed under the Bank's technical assistance and trigger for upcoming DPC.

16. **Financial infrastructure modernized and access to finance improved.** The CPS program mostly achieved its target and key milestones have been achieved. The Bank and IFC jointly supported RGoB for the development of sound financial system through investment lending, analytical and technical work. The government prepared a Financial Inclusion Policy (FIP)<sup>29</sup> which is based on the recommendations from the Bank supported diagnostic study “Financial Inclusion Focus Group Survey”. The survey provided demand side evidence at the household level on access to finance across Bhutan’s urban-rural communities. A national financial literacy campaign using innovative social media (radio and TV drama) was launched and aired through local cable networks. Financial sector payment infrastructure was modernized to service increased number of transactions. The IT system upgrade in the Bank of Bhutan (BNB) led to a one hundred and fifty fold increase in ATM transaction<sup>30</sup>. The modernization of the payments systems has led to the fully functioning of Electronic Funds Transfer Clearing System (EFTCS) inaugurated in June 2010 in Thimpu. The EFTCS is expected to expand to other regions and the coverage of EFTCS increased from 22 to 37 institutions from March 2011 to January 2012. Subsequently, IFC complemented these efforts through capacity building on national payment systems, training on trade finance and advisory assistance for the two leading banks. IFC’s \$29 million equity investment support in Bhutan National Bank (BNB) additionally helped increase its SME finance, including through risk management strengthening. This is the largest Foreign Direct Investment in Bhutan’s history to date and IFC’s first equity investment in the country. Through meeting IFC’s requirements, the investments in developing and strengthening the BNB framework that could demonstrate to upgrade future financial sector practices, such as in the areas of environmental, social and risk management. Insurance and impact related borrower data.

17. **Corporate governance of State Owned Enterprises (SOEs) strengthened.** The CPS has achieved this outcome. The Bank’s technical assistance provided training to 59 Druk Holding and Investment (DHI) companies directors in an internationally renowned institute. DHI has developed model corporate governance documents and a corporate governance codes which provide guidance on board practices and responsibilities in SOEs. Implementation of the CG codes and documents has already been started in 6 of the 17 SOEs, which is consistent with international standards. The remaining SOEs will progressively implement the codes over the next two years. These initiatives are expected to improve good governance practices and improvement of transparency and accountability in SOEs in Bhutan. The training program to 59 directors made significant impact of leading the companies for improved performance and accountability. The Bank’s program made significant impact on introducing more efficiency, discipline and accountability on the activities of the Board members as well as the management of running day to day operations of the SOEs. However, at the beginning of the implementation DHI faced difficulties finding known international experts in the field of corporate governance. The Bank team helped DHI to access a network of qualified experts within the World Bank Group’s internal network. In addition, operationalizing the corporate governance code and performance monitoring systems among SOE were critical part in implementing CG reforms. Given the success of the program with DHI, other SOE’s under the Ministry of Finance’s direct ownership have requested for similar assistance. To complement, IFC has been assisting with the Central Bank in improving corporate governance among financial institutions and stock-exchange listed companies.

## **Results Cluster 2: Employment and Skills Development**

18. The Bank’s engagement focused on assisting RGoB’s efforts to diversify training options and increased employment opportunities for Bhutanese youth. A combination of knowledge, lending and

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<sup>29</sup> The FIP is being reviewed as part of the Bank’s ongoing work on Financial Sector Strategy and the implementation of the FIP will be through the financial sector strategy action plan.

<sup>30</sup> The Bank of Bhutan holds 46 percent of the bank’s assets. In 2013 the ATM transactions increased more than five times in three years.

technical assistance provided support to improve labor market insertion and addressed the skills demand and availability.

19. **Significant progress has been made in improving technical and vocational training.** Approximately, 1,372 secondary and tertiary graduates have been trained – which exceeded the CPS target. The Bank supported training programs enhanced IT sector skills and increased employment opportunities. These training programs were implemented through potential private investors who provided part of the training costs and customized skills development according to the industry needs. About 320 graduates were trained through a Graduate Training Program (GTP) of which 206 are employed in the private sector. Similarly through employment training program (ETP) 451 candidates completed training and 303 candidates have already been employed. Under both programs the firms were responsible for mobilizing candidates and required to employ at least 50 percent of the trained individuals. The Bank provided matching grants as an incentive to the local firms to train and hire the Bhutanese youth graduates. During the CPS period a total of 1,015 new jobs were created which represents 15 percent of the total unemployed Bhutanese and 29 percent unemployed youth<sup>31</sup>. These employees are between the ages of 19 and 24 years, with equal representation between young men and women across Bhutan's 20 districts. Six<sup>32</sup> new learning offerings were made available to the youth. In addition, Royal University of Bhutan (RUB) introduced three credit courses: including academic skills, analytical skills and entrepreneurship in the RUB curriculum. Partnership with the industry and academia outside Bhutan, including via train the trainers program proved to be critical in the development of new curriculum at RUB.

20. **The private sector led training approaches have been successful in changing the overall vocational training strategies.** This model is being replicated by the Ministry of Human Resources (MOLHR) to implement training programs in other sectors. The skills development program will not only be useful for an IT/ITES firm but also for any businesses in Bhutan. Majority of the youth gained significant professional skills beyond IT skills which included communication, analytical and presentation. In addition, the Bank's program generated ICT mindset among Bhutanese firms and entrepreneurs. Investment promotion and skills development programs highlighted Bhutan's value proposition as an IT services investment location. New concepts in employment creation are being explored for future. Self-employment and entrepreneurship are now increasingly considered as viable alternatives to public sector jobs.

21. **The CPS program also helped strengthened the institutional capacity of Ministry of Labor and Human Resources to facilitate employment of Bhutanese youth.** The Bank provided technical support<sup>33</sup> in training, supervising and negotiating public sector training providers to the Ministry of Labor and Human Resources (MoLHR). As a result of these initiatives MoLHR were able to provide their own training to approximately 145 youth in tourism and hospitality sector. The MoLHR developed innovative PPP's with 6 private sector training providers which exceeded the original program target of 4. In addition, the Regional labor and employment offices provided support to 123 job seekers a month on average. The training provided by MoLHR was the first to directly link academia and business in Bhutan. However, challenges remain during the training period the MoLHR found that most young people are not willing to take up the skills development training. The uptake of the training has been slow and as a consequence had to motivate the youth to join and provide incentives (ex: stipends) and accepting everyone who applies (without screening). There is still lack of knowledge of labor market conditions both from the demand and supply side. MoLHR will explore possibilities of better understanding the barriers of young people participating in the skills development training. The Bank will also see additional opportunities and resources to support the RoGB in tackling the challenge of youth

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<sup>31</sup> Private Sector Development Project ICR-December 2013.

<sup>32</sup> In arts and crafts, beauty care, bakery, culinary arts, commercial cooking, textiles etc.

<sup>33</sup> Institutional Development Fund (IDF).

employment. Currently, the Bank is preparing a labor market scoping note and plans to conduct a labor force survey next fiscal year to address some of these issues.

### **Results Cluster 3: Sustainable Urban Rural Development**

22. The CPS under this cluster focused on three areas: (i) supporting the provision of urban infrastructure and capacity building; (ii) increasing rural infrastructure and access to markets and (iii) strengthening institutional capacity for disaster risk reduction and preparedness. The Bank supported several infrastructure investments and leveraged trust fund resources to implement programs under the above cluster.

23. **Access to urban infrastructure improved moderately but further advances are a priority.** The CPS target has been achieved mostly. The Bank's support through the Second Urban Development Project provided assistance in developing basic infrastructure in the northern Thimpu area including roads, storm water drainage, water supply, sewerage and street lighting. These progresses are well below the anticipated target identified in the CPS. During the CPS period 300 service plots<sup>34</sup> have been completed which exceeded the target of 200. In addition 6.3 km of roads were completed in the local area plans (LAPs). However, only 100 households have been connected with new piped water and sewage connection which are lower than revised target of 150. Works on two local area plans (LAPs) are still ongoing and the remaining targets are expected to be achieved in the early part of the next CPS cycle. Although the targets for the indicators were revised during the CPS PR even then it was overly optimistic to achieve results in such a short period. It should be noted that while the Bank took necessary measures for the implementation of the program but there were several factors contributed the delay in implementation of the program at the beginning. These are: procurement, lack of technical capacity particularly inadequate contract management, shortages of labor and lack of supervision are one of the key impediments for achieving good results. The lessons learned from the implementation of this program were taken on board for the additional financing of the Second Urban Development Project Subsequently, IFC supported PPP advisory services for Thimpu city transportation service is expected to decongest city traffic and better public mass transit services.

24. **Steps were taken to strengthen capacity of municipal finance and management services but challenges still remain.** The CPS program partially achieved this target. Management of municipal services finance has improved in the city corporation of Thimpu and Phuntsholing. After initial delays the Municipal Finance Policy was approved in July 2012 and selected priority measures from the policy are being implemented in the Thimpu and Phuentsholing Thormdes. The CPS program has helped strengthened the local revenue administration and improving the expenditure management systems. The work on initial stages (digitization of tax and non-tax records and asset register) has been completed. About 6,000(4,500 in Thimpu and 1,500 in Phuentsholing) tax records have been digitized in Thimpu Thormodes. The property tax records computerization is almost complete and training courses on Municipal Financial Management have been given to the technical staff. However, much work is still needed to meet the CPS target which is expected to be complete during the next CPS cycle. For example: the preparation of revenue administration manuals and re-engineering of revenue collection process is still under progress. Advisory support is being provided for strengthening expenditure management systems of Thromdes as well as for strengthening the intergovernmental fiscal transfer systems.

25. **Notable progress has been made in expanding access to rural infrastructure and improving rural livelihoods.** The CPS programs helped to increase community irrigation schemes, agricultural extension and access to rural roads. The Bank through several investment lending operations supported the targeted areas mostly in south and central Bhutan focusing on the poorest and most remote communities in the district. Good results have been achieved in building new roads (both farm and feeder roads) and also improving existing roads. About 95.5 km of farm roads have been constructed and another

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<sup>34</sup> Individual household plot.

43 km of farm roads were improved. As a result, 8,272 households benefited from improved infrastructure and over 8,703 households through extension services. In addition, 100 percent of the targeted feeder roads (67 km) have been constructed and improved to all season standards (23km)<sup>35</sup>. The Bank's intervention also helped to improve food crop production (rice, maize potato) in the targeted communities through improved agricultural extension services. These initiatives have benefitted 78 percent of the targeted rural communities who are enjoying frequent trips to local markets, access to agriculture services and other economic facilities. Travel time access to these facilities also reduced significantly by fifty percent (from 3 hours to 1.5 hours). Although CPS results matrix identified for establishing community groups for road maintenance, the indicator was not measured through any of the Bank supported activities. The CPS program was not clear about identifying the right indicator and did not revise the indicator during the progress report. However the Bank's ongoing program has involved communities in identifying community infrastructure. Therefore, by virtue of constructing the farm road through the CPS programs have led to better access to markets, reduced transportation costs and access to agricultural services.

26. **The target to increase share of beneficiaries with improved drinking water and sanitation services were not met.** This outcome was revised during the CPS PR which reflected the Government's strategy and priority. The program to achieve the outcome has only recently been effective and it is too early to show any significant result. Therefore, the target was not realistic to achieve. However, the project is undertaking participatory implementation plan to assess the need and identifying districts where the drinking water and sanitation services will be implemented. The CPS program should have considered that the capacity constraints and challenges of implementing investment lending operations in the context of the country's limited human and institutional capacity. In addition, it is not only the capacity constraints from the Government side but also from the Bank's fiduciary and other procedures delays the implementation of the program. Therefore, it also reflects the design of the CPS program was not selective enough about the goals it could have achieved in these areas. The choice of indicator was also an issue.

27. **Significant steps were taken to strengthen capacity of key institutions for an effective disaster management system.** The CPS supported several activities to enhance capacity of the Department of Disaster Management and relevant DRM focal persons in order to better understand disaster management and associated mitigation measures to respond to disasters. The Bank was successful in leveraging technical assistance funds for capacity building programs which was the most efficient way of supporting Bhutan in adapting the impact of climate change. The technical assistance contributed the institutional setup of disaster management in the country. It also contributed to capacity building program for seismic engineering including the development and piloting of a vulnerability assessment checklist for schools and hospitals. The training program in Light Urban Search and Rescue has been provided to the National Search and Rescue Team and the rolling out of trainings at the district level has been initiated. In addition, a Technical Assistance Program (TAP) for piloting the use of probabilistic risk assessment in Bhutan has been completed. A recently approved PHRD Grant "Improving Seismic Resilience in Bhutan" will build on these activities to enhance the understanding of earthquake risks in Bhutan as well as opportunities and challenges associated to its mitigation.

28. **The Bank successfully supported the Government's policy and actions plan on disaster management.** The policy dialogue and the prior actions through the DPC series facilitated the enactment of the Disaster Management Bill. The RGoB enacted the Disaster Management Act in 2013 and the draft Rules and Regulation for operationalization of the new legislation have been prepared. This is a substantial achievement where the Act will help improve mitigation of disaster management through a systematic and streamlined approach. The National Action Plan for schools and hospitals has been completed and the recommendations from the action plans are integrated in the RGoB's 11<sup>th</sup> Five Year

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<sup>35</sup> ISR and ICR

plan activities for the Education and Health Ministries. The vulnerability assessment forms for schools and Basic Health Units (BHU) have been compiled and handed over to the respective Ministries.

29. **The Bank program also faced challenges in implementing some of the above initiatives.** The lack of coordination among various agencies with similar objectives and weak technical capacities of the government counterparts posed challenges in implementing some of the activities. Implementation of the Bank executed grants has been also challenging particularly following the Bank's guidelines which in some cases resulted in delaying some of the business process.

#### **Results Cluster 4: Access to Quality Public Services**

30. The CPS under this result cluster supported RGoB's efforts to increase the efficiency of public service delivery and diversify Bhutan's higher education system. In addition, the CPS also supported the Government in promoting awareness in the health and nutrition front to create more visibility. A combination of lending, technical assistance and knowledge products provided improved results.

31. **Public expenditure and service delivery standard reporting systems have been improved.** The CPS has achieved this outcome. A mix of policy and institutional reforms brought about through DPC series and several analytical works<sup>36</sup> supported the RGoB in better understanding poverty, quality of expenditure management and where public spending has the greatest impact. These activities have helped the government develop a Multi-Year Rolling Budget (MYRB) system, fine-tuning the annual capital grants to provinces, and preparing the 11<sup>th</sup> five-year plan. MYRB and Public Expenditure Management Systems (PEMS) have been rolled out across all spending agencies which now capture all of RGoB budget implementation. The web based financial reporting tools for budget and expenditure (MYRB and PEMS) are now integrated and well-coordinated within the sectoral ministries. This integration should result in an overarching monitoring and evaluation framework for the country. In addition; DPC series supported the government in developing and implementing service standards across sectors. Service delivery standards have been developed and reported to national assembly in all ministries, twelve autonomous agencies and twenty dzongkhangs for priority services. This will result in a more efficient, transparent and citizen friendly system.

32. **Significant milestones have been achieved in strengthening public financial management and country systems.** The Bank has been actively engaged through analytical and technical advice for strengthening the government's PFM reform program and its action plan. Based on the recommendations from the PEFA<sup>37</sup> report the RGoB prepared a comprehensive, time bound and sequenced action plan (The PFM reform program). The implementation of the PFM action plan is expected to improve the quality of public spending in the national PFM framework. This action plan is being monitored by the PFM Governance Group and being formed and will be used by other development partners as the basis for their engagement with RGoB to support improved PFM. The government made effort to improve some of the PEFA indicator. For example, financial rules and regulations are being amended (P1-24); internal audit function is currently being strengthened (P1-21) and legislative scrutiny of budget law is improving since the new government was formed last year (P1-27). The Bank is planning a follow-up PEFA review next FY which should confirm some of these improvements. The Bank's active engagement has also enhanced usage of country systems and better fiduciary assistance. Currently, all Bank-financed projects in Bhutan now fully use the country financial management systems for budgeting, accounting, internal control and financial reporting. Progress has also been made in implementing recommendations of the Use of Country Systems (UCS) Assessment, which include issuances of a procurement user's guide, strengthening the Public Procurement Policy Division (PPPD), establishing a PPPD website, creating an independent bid review body, publishing contract awards and revising Standard Bidding Documents for goods and works.

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<sup>36</sup> Poverty mapping exercise, PEFA report, HD PER.

<sup>37</sup> PEFA Report of June 2010 (made public in March 2011)

The Bank will continue to support the RGoB in strengthening financial management in the public and private sectors.<sup>38</sup>

33. **The CPS program partially achieved its objectives in the area of tertiary education.** Initially, CPS envisaged a broader focus to facilitate support to increase access and diversify higher education through a new knowledge economy project. However, the outcome had to be dropped because the intended project was postponed to let the first PSD project mature and yield lessons for future projects. Therefore, CPS could only rely on the analytic work undertaken to move forward under the thematic area. Specifically, a *Higher Education Policy Note* was prepared and the findings from the report were a key input into the RGoB preparation of their Quality Assurance and Accreditation Framework (QAA). The study also directly fed the Public Expenditure Review in the human development areas which should also provide relevant evidence to inform policy in the near future.

34. **The knowledge work in health and nutrition promoted awareness and provided policy options for the Government.** The analytical work on Nutrition assessment was carried out and disseminated widely through advocacy and workshops. The leadership role of the Bank along with other development partner's helped to identify nutrition as one of the four priority areas of the social sector under the 11<sup>th</sup> five year plan. The study identified how gender, livelihoods, economy and water and sanitation influence health and nutrition outcomes in the community. The study provided recommendations for strengthening government program design aimed at improving health and nutrition indicators across the lifecycle with a focus on the first 1000 days of life comprising the prenatal and early childhood period. Implementation of recommendations of the policy notes is only now taking place but the Bank team will continue to support through policy dialogue so that the persisting malnutrition challenge remains center stage of policy makers attention.

#### IV. World Bank Group Performance

##### *Design:*

35. **The design of the program was relevant and was well aligned with the RGoB's key strategic framework Bhutan 10<sup>th</sup> Five Year Plan and the principles of Bhutan's homegrown development philosophy of the Gross National Happiness (GNH).** The WBG's engagements remained focused on economic growth, employment generation while supporting the expansion and sustainability of quality public service. The CPS was mindful of the RGoB's human capacity constraints as well as Bank Group's limited resources. The design of the results framework took into account the lessons learned from the previous CAS, linking the results more tightly with the interventions. In the majority of the cases, there were good linkages between the results areas, outcomes and indicators. In some cases, certain outcome indicators were mostly outputs and were not practical to assess progress.

##### *Implementation:*

36. **Implementation of the CPS program was efficient.** The WBG provided a good mix use of instruments which was a realistic and appropriate balance between programmatic budget support operations and investment lending. The lending program was selective in terms of sector engagements given its small IDA envelope and effective synergy with the IFC program. In addition, the CPS program was also flexible enough to respond to the Government needs during the crisis. For example, the Bank provided an additional financing through the DPC series to help meet the government financing needs following the 2011 earthquake and ease the balance of payments deficit. The designs of few operations were notable. Among them were the Second Rural Access Project, Private Sector Development Project and Sustainable Land Management Projects stand out.

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<sup>38</sup> The IDF grant approved in Sept 2012.

37. **Innovative concepts were implemented in the road sector.** The recently completed Second Rural Access Project (RAP II) continued from the First Rural Access Project used Environment Friendly Road Construction (EFRC) Concept successfully which the government welcomed. It is not only a safe construction method but also aims to improve the road planning and selection. EFRC avoids geologically, environmentally or culturally vulnerable areas right from the planning stage of the road. It is expected that the Government will continue to use EFRC concept in future infrastructure projects even if there are no Bank supported program.

38. **The CPS program through GEF funding assisted RGoB in demonstrating effective application of land degradation prevention approaches.** A participatory land management and resources were applied which involved active participation of local communities. The adoption of inclusive approach for sustainable land management (SLM) was important for Bhutan because it reached out to most of the vulnerable communities while addressing the underlying issues, including the challenges of convincing farmers and other stakeholders about the long term benefits of SLM. The Bank's technical expertise facilitated institutionalizing of successful sustainable land management practices in the Government's five year national planning program. The multi-sector approach adopted by the project proved to be an effective as the wellbeing of the environment and natural resources is fundamental to the long term sustainability of many sectors.

39. **Programmatic budget support operations have been effective.** The Development Policy Credit operations were designed to preserve continuity of reforms, to leverage stronger policy actions and to better monitor implementation of institutional measures. DPC series made significant contribution during the critical transition of Bhutanese economy. The program supported the soundness of the macroeconomic policy framework and institutional reforms while providing additional financial resources to the budget. The programmatic approach was highly relevant throughout the implementation period to the government reform agenda in the 10FYP document. The Bank worked in partnership with the RGoB in the design and preparation of the program of reforms that is relevant to the country's own strategy and consistent with its priorities. The positive aspects of the implementation of the program included government ownership and commitment to the reform agenda, donor support and coordination and the quality of the analytical underpinnings.

40. **IEG analysis of closed projects during the CPS period has been insightful.** Five operations in education, HIV/AIDs, institutional capacity building, roads and private sector development closed with the IEG ratings of first four moderately satisfactory, unsatisfactory, moderately satisfactory and satisfactory respectively. Some of the key lessons learned were: monitoring and evaluation should be tailored to country's limited capacity, government's leadership is crucial to the achievement of large scale national program, design and results targets of the project should be simple, focus more on building country systems rather than targeting delivery to particular group, specific guidelines need to be tailored to local situations while applying environment friendly construction framework.

41. **The recent Country Portfolio Performance Review (CPPR) identifies few areas for improvement going forward.** These are: providing training opportunities for the PMU and line ministry to understand the Bank's fiduciary aspect of project management; strengthening client capacity for monitoring and evaluation; an overarching monitoring and evaluation framework for the country need to be set-up linkages between financing and performance of sectoral ministries, human resource constraints to identify international experts; there is a need to increase procurement capacity and to increase the focus on capacity building for local government.

42. **Strong demand driven knowledge program complemented the CPS program.** Given the small IDA envelope, the Bank's engagement through AAA work was instrumental and gave greater prominence to some areas where no lending was envisioned. A number of cross sectoral analytical pieces and non-lending technical assistance (NLTA) provided policy and implementation advice to policymakers. *The Investment Climate Survey* findings and consultations provided constructive dialogue



and accelerated finalization of key investment climate policies. The key findings from the household survey on financial inclusion informed the national Financial Inclusion Policy (FIP) and drew out strategies and action plans. “*The Higher Education Policy Note*” provided policy recommendations in strengthening Bhutan’s tertiary education that contributed framing of the Government’s strategy on higher education. The study also complemented the *Public Expenditure Review (PER)* in the health and education sector. PER helped the government identify the causes of inefficiencies and understanding of public financing in health and education. A national nutrition assessment and gap analysis has been undertaken which focused on the high prevalence of stunting and anemia in the country as reported in the BMIS<sup>39</sup> 2010. Findings from the Nutrition Assessment and Gap Analysis have been discussed with the health, education and agriculture ministry officials. However, election process limited the opportunities for continued interaction and delayed dissemination. *The Gender Policy Note* contributed to the overall knowledge of gender issues in Bhutan by investigating economic and social factors behind the gender gaps. In terms of the role of gender gaps in job quality the report identifies three key factors: education endowment, gender segregation in the labor market and gender roles in the households. The report was widely disseminated with wide coverage of television and print media. The finding from the recently completed *Poverty Assessment* report argues that the current pace of poverty reduction is sustainable in medium-term by continuing trade intensification with neighbors, expansion of road infrastructure and construction of more hydroelectric project. In the long term sustainable poverty reduction will depend on addressing persistent shocks, removing binding constraints to prosperity and defining clear target groups for poverty reduction. It is expected that the findings from the report will be disseminated to the wider stakeholders. A green growth policy note has been prepared during the current CPS period.

43. The Bank was also proactive in knowledge sharing, including sector policy notes, which contributed to meaningful policy dialogue with the new Government. In addition, the Bank also organized several just in time seminars which included participants from the Government, private sector and academia. Some of the key seminars are on Better Business Summit, Sustainable land management workshop, Electric Vehicle Initiative etc.

44. **Synergy between the Bank and IFC interventions contributed positive results in the CPS program.** IFC advisory services particularly in the areas of business environment and financial services complemented the Bank’s work in these sectors. Some key areas where IFC worked on included: PPP advisory for an urban transit system for Thimpu and Phuensholing, a parking facility in Thimpu, improving investment climate through licenses simplification project, financial sector capacity building and diagnostic studies on special economic zones, power trading company and for the national airliner.

45. **Overall performance of the portfolio is healthy with no problem project or potential problem projects.** During the CPS period Bhutan’s portfolio became more selective, reduced from eight operations in FY10 to three at present with US\$ 29.7<sup>40</sup> million undisbursed. The portfolio has a mature profile with an average project age of 3 years. Project implementation is generally satisfactory with historically high disbursement rate. Disbursement ratio has remained robust at 38 percent since FY 11 which is above the South Asia average.

46. **IFC’s committed and outstanding portfolio during the CPS period stands at US\$30.57 million.** A \$29 million in equity investment in BNB, the largest IFC investment and foreign direct investment in Bhutan’s history was committed in FY13. In FY11-14, the total investment support reached at US\$32 million compared to US\$11.4 million supported before the CPS period since Bhutan became the IFC member in 2003. The portfolio also consists of a tourism investment and trade guarantees for SMEs through Global Trade Finance Program, provided to two Banks.

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<sup>39</sup> Bhutan Multiple Indicator Survey 2010

<sup>40</sup> This includes \$3.1 mil of GEF Biodiversity Project and also AF of US\$17 mil for Second Urban Development Project.

47. **The overall IDA and IFC financing during the CPS period remained valid.** The delivery of the IDA commitments was roughly in line with the initial commitments. Bhutan's IDA allocation has grown from US\$78 million as anticipated under the CPS to US\$81 million. The CPS included five lending operations<sup>41</sup> of which three were delivered. During the CPS PR the IDA portfolio was slightly revised to accommodate remaining IDA 16 financing. Therefore, the funds have been increased for DPC 2 and additional financing for the current urban project rather than follow on to the private sector development project.

48. **Trust Fund resources served as a vital complement to the Bank's program supporting lending activities, technical assistance and analytical work.** During the CPS period a total of US\$ 26.23 million Bank and Recipient Executed trust funds<sup>42</sup> were signed. These trust funds were fully coordinated and integrated into the portfolio and into the results framework of the CPS. Two large trust funds (GEF and GFDRR) and institutional development fund (IDF) supported activities in areas such as public financial management, procurement, corporate governance, capacity building, and disaster risk management. In addition, in the urban sector, the Bank's program worked closely with the Asian Development Bank (ADB) where they had parallel TA. In the area of rural development the Bank also collaborated with IFAD. The Bank's work on disaster risk management was collaborated with JICA and through Japanese Trust Fund.

## V. Key Lessons and Suggestions

49. **Programmatic approaches will have unique advantages for Bhutan's future lending.** Budget support operations provided an important forum for dialogue especially on issues related to structural reform. It also added value to the CPS program because they are quick disbursing operations and were deployed flexibly by the RGoB. Areas of engagement for reform should be chosen carefully as resources are limited. The programmatic policy lending series helps to sustain the momentum of reforms while enabling the WBG to remain engaged with the government in supporting the implementation of policy reforms. This approach helps build a constituency for the reform program in a well-sequenced and incremental way. The full integration of analytical work, technical assistance and policy financing is important to maximize results.

50. **Capacity building constraints must be identified and main streamed more clearly in the CPS program.** One of the lessons coming out from the DPC series is that institutional capacity is usually the key constraint affecting the progress of reforms. Technical assistance and capacity building efforts are essential to help the reform momentum. The DPC series mobilized technical assistance to support the government counterpart in their work and build the institutional capacity. The upcoming strategy should take a more realistic and strategic view of institutional reforms rather than making unilateral commitments that lack credible backing from the counterpart. The Bank can leverage resources through IDF or Trust Fund support for capacity building program.

51. **An effective monitoring system is needed to implement the CPS program** Monitoring and evaluation of the results should be aligned with and reviewed as part of the WBG's portfolio monitoring. While in majority of the cases the CPS results framework was aligned with the program, it was extensive and some cases did not take into account of the likelihood of achieving some of the results. In some cases, relevance of the indicator couldn't be properly assessed as it was not linked to the outcome objectives and Bank's intervention. While some of the outcomes/indicators were revised during the CPS PR still targets were set too high in some cases. Going forward, results framework should take into account the size of the CPS program and be more precise, realistic and selective. Having eighteen outcomes for small program like Bhutan was overly ambitious and unrealistic.

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<sup>41</sup> It excludes trust fund and GEF operations.

<sup>42</sup> \$2.3 million Bank Executed and \$23.8 million.

52. **Strong prioritizations of lending and non-lending activities are needed.** Since Bhutan has limited IDA resources it is useful to identify where lending and non-lending activities will be more effective for better results. If resources are too fragmented the impact will be limited and difficult to supervise. The CPS activities need to be strategic, sequenced and targeted to areas for realistic prospects. For example, analytical work on Investment Climate along with the private sector development project provided constructive dialogue and accelerated finalization of key investment policies. Findings from the several analytical pieces by the Bank influenced the design of the DPC series as well as the formulation of some of the prior actions during the CPS period. Going forward, the Bank should evaluate its AAA work, looking especially at its usefulness and potential impact. In this regard, a more focused portfolio with fewer projects will allow greater resources for policy dialogue and support for AAA as needed.

53. **The WBG should continue to build on successful interventions to produce results.** During the CPS period some of the operations were successful and have been able to improve results. For example: Private Sector Development Project, Second Rural Access Project. The future CPS should continue building on these successes of these projects through policy dialogue or technical assistance to produce further results and sustainable impact.

54. **The WBG should continue to build on long term partnership with the client.** As Bhutan becomes a blend (IDA/IBRD) country in the next CPS period, the WBG should re-adjust its role and emphasized areas where the WBG will have comparative advantage.



### Annex 3 A: Summary of CPS Program Self Evaluation

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
<b>Results Cluster 1: Private Sector Development</b>			
<p><b>Outcome 1:</b> Improved framework of policies, procedures and practices resulting in more efficient process of business start-up, project approval and licensing for domestic and foreign investors as measured by</p>	<p><b>Mostly Achieved. (all key milestones have been achieved)</b></p>	<p><b><u>Completed/Ongoing Lending:</u></b> DPC1 (completed) DPC 2 (completed)</p> <p><b><u>Completed/Ongoing AAA:</u></b>  <ul style="list-style-type: none"> <li>✓ Investment Climate Policy Dialogue (completed)</li> <li>✓ Licensing Simplification TA (IFC) (Completed)</li> <li>✓ Access to Finance AAA(completed)</li> <li>✓ Doing Business Reforms NLTA (Ongoing)</li> <li>✓ Poverty Mapping (Completed)</li> <li>✓ Corporate Governance TA (Ongoing)</li> <li>✓</li> <li>✓ IDF on improvement of PFM (completed)</li> <li>✓ Strengthening PFM IDF (ongoing)</li> </ul> </p>	<ul style="list-style-type: none"> <li>✓ Bank's investment policy dialogue and Bhutan PSD project laid the foundations for drafting of the EDP. Some of the policies were captured in the DPC policy matrix.</li> <li>✓ Combining a trigger in the DPC with TA from IFC to support the approval of the FDI rules and regulations was an example of how combined WBG instruments can support Government effectively.</li> <li>✓ To support RGoB's efforts to improve its investment climate, combined WBG instruments are being used as well. WB continues to support through NLTA in drafting govt action plan, building on DB Reform Memorandum and implementation of the identified reforms will benefit from IFC support as well as WB support for post-NLTA through the next DPC.</li> </ul>
<p>(i) Number of days to start a business <i>Baseline: 46 days in 2010</i> <i>Target: 30 days in 2014</i></p>	<p><b>Target achieved.</b> As of 2014 it takes 32 days to start a business. RGoB is very keen to implement reforms that will reduce the numbers of days to start a business. The Bank is currently providing NLTA for Doing Business Reforms. A Doing Business Reforms, an investment climate reform memorandum (memo) was prepared and shared with the RGoB. An action plan was formulated building on the recommendations of the memo. The RGoB has also established an institutional framework for the reform process directly under the authority of the Prime Minister. This includes a task force (involving the private sector) in charge of implementing the reforms formulated in the action plan and a body cutting across all agencies (the Doing Business Steering Committee) which will act as an advisory board and will be headed by the Prime Minister.</p>		
<p>(ii) Increase in the number of FDI project approvals <i>Baseline: 20 approvals in 2009</i> <i>Target: 25 approvals in 2014</i></p>	<p><b>Achieved. As of now 32 FDI projects have been approved.</b> Rules and regulations were issued and an amendment to the FDI Policy approved by Cabinet in July 2012.</p>		

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
	<p>IFC also completed (i) FDI process streamlining and (ii) Large approval processes.</p> <p>IFC made the largest FDI in Bhutan in history thus far with its support for Bhutan National Bank (BNB) demonstrating a positive signal to the market.</p> <p>RGOB approved EDP in April 2010. A number of policies and laws are being formulated or reviewed to implement the EDP including business licensing policy (which is in advance stages of approval), simplification of industry etc. Accounting and Auditing Standards Board of Bhutan (AASBB) has issued notification to fully adopt the International Financial Reporting Standards by 2021 in phased manner and has developed Bhutanese Accounting standards for the interim period. These standards apply to Bhutanese companies in reporting financial results.</p>		
<p><b>Outcome 2:</b> Increased number of public private partnerships  <i>Baseline: 1 in 2010</i>  <i>Target: 3 in 2014</i></p>	<p><b>Mostly Achieved. (Two third of its target have been achieved)</b>  <b>2 out of 3 PPP projects have been achieved under PPP.</b> The IT Park has been a flagship and pilot for public private partnerships in infrastructure and service delivery. IFC's Thimpu Parking Project is expected to have a private developer come in this FY.</p> <p>The PPP Policy has been drafted with support from the Bank and expected to be adopted soon (as election last year delayed approval of the policy). In addition, an institutional framework has been drafted following consultations with stakeholders.</p> <p>IFC completed diagnostic of some PPP projects- dry port, agri storage, bus terminal and parking. Only the parking project has been implemented.</p>	<p><b><u>Completed/Ongoing Lending:</u></b></p> <ul style="list-style-type: none"> <li>• Bhutan Private Sector Development SIL</li> </ul> <p><b><u>Completed/Ongoing AAA:</u></b></p> <ul style="list-style-type: none"> <li>• Improving capacity to implement infrastructure PPPs (TA) – (Completed)</li> <li>• Construction Sector Assessment</li> <li>• Support for Thimpu Parking Project (IFC ongoing)</li> <li>• TA- PPP Rules &amp; Regulation (Planned)</li> </ul>	<p>Capacity building of senior officials of the Royal Government and its implementing agencies about the concept and the best practices of PPPs is important. It is important to gather support on PPP policy from various agencies in addition to only the main agencies (eg: MoF)</p> <p>WB-IFC can jointly work where Bank can assist RGoB in policies, rules and regulations while IFC could test those with real transaction.</p>
<p><b>Outcome 3:</b> Financial Inclusion Policy Implemented  <i>Baseline: No policy framework</i>  <i>Target: 100% implementation of the policy</i></p>	<p><b>Mostly Achieved. (3 key milestones have been achieved)</b>  Financial Inclusion Policy was developed that draws out policy objectives, strategies and an</p>	<p><b><u>Ongoing/Completed Lending:</u></b></p> <ul style="list-style-type: none"> <li>• Bhutan Private Sector Development SIL (completed)</li> </ul>	<p>✓ Increased ratio of private credit to GDP alone is not sufficient to lead to better access to finance. A strong well-functioning and sound financial sector is</p>

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
	<p>action plan to increase financial inclusion. It was approved in principle in June 2012 until endorsement by the newly formed government. FIP is in the process of being reviewed and endorsed. The Bank's ongoing work aims to draw a financial sector strategy and master plan. It is likely that the implementation of the FIP will be through financial sector strategy. A financial literacy program was developed and a campaign was launched using innovative channels (radio and TV drama) and aired through local cable networks in 2013. Electronic Funds Transfer Clearing System (EFTCS) was inaugurated in June 2010 in Thimpu and will be expanded to other regions. As of May 2013, Nu 41.51 million worth of transactions processed monthly through the EFTCS a 9.9% increase since January 2012. The stock exchange (RSEBL) was launched in April 2012. It has integrated six systems: Automated Trading System, Electronic Depository System, Clearing and Settlement System, Market Surveillance System, Broker's Back Office and Initial Public Offering. Data following automation show an increase in the number of shares traded in the secondary market by about 620 percent while market capitalization also reportedly increased by 42 percent.</p>	<ul style="list-style-type: none"> <li>• DPC1 (completed)</li> <li>• DPC2 (Completed)</li> <li>• IFC Equity Investment in BNB 28.5 Mil USD.</li> <li>• Support for Financial Institutions through trade-line, credit-line and equity investments (IFC)</li> </ul> <p><b><u>Ongoing/Completed AAA:</u></b></p> <ul style="list-style-type: none"> <li>• Access to Finance AAA (completed)</li> <li>• Poverty Mapping(Completed)</li> <li>• E-Governance TA (completed)</li> <li>• ICT Sector Policy TA (completed)</li> <li>• Access to Finance TA to banks (IFC- ongoing)</li> <li>• SME finance TA (IFC)</li> </ul>	<p>required to fund private sector investment.</p> <ul style="list-style-type: none"> <li>✓ Improved usage and quality of access through modernized financial infrastructure contribute to inclusiveness of the financial sector.</li> <li>✓ The Bank will continue to support government through programmatic AAA on Financial Sector Strategy.</li> <li>✓ IFC's investment and advisory work for the financial sector including SME finance TA and trade-lines has well complemented the WB's work in this outcome.</li> </ul>
<p><b>Outcome 4:</b>Improved corporate governance for SOEs as measured by The number of SOEs implementing new Corporate Governance framework <i>Baseline: 0</i> <i>Target: 5</i></p>	<p><b>Achieved.</b> 6 out of the 17 SOE's started implementing CG codes and documents. All SOEs will progressively implement the codes over the next two years. 59 Druk Holding Investments (DHI) companies directors have been trained in an internationally renowned institute, against an end of project target of 33. This has made significant impact of leading the companies for improved performance and accountability. The Bank's program made significant impact on introducing more efficiency, discipline and accountability on the activities of the Board members as well as the</p>	<p><b><u>Lending:</u></b></p> <ul style="list-style-type: none"> <li>• Corporate Governance IDF Grant (WB) (Ongoing)</li> </ul> <p><b><u>AAA/NLTA :</u></b></p> <ul style="list-style-type: none"> <li>• Financial Sector Corporate Governance TA (IFC)(Ongoing)</li> </ul>	<ul style="list-style-type: none"> <li>✓ Joint WB-IFC collaboration has been effective in supporting RGoB in increasing corporate governance standards.</li> <li>✓ Need to create space in the next CPS for follow on CG engagement.</li> </ul>

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
	<p>management of running day to day operations of the SOEs.</p> <p>Development of all corporate governance documents and codes has been completed. The CG documents and codes include Ownership Policy, Board Charter, Audit Committee Charter, Code of Conduct and Company Security Charter. Series of dissemination workshops to the public, journalists and members of the RGoB and parliament were completed in November 2013. These workshops were aimed to raise awareness of the importance of good Corporate Governance and reforms achieved to date in Bhutan.</p>		
<b>Results Cluster 2: Employment and Skills Development</b>			
<p><b>Outcome 5:</b> Competency-based curricula in place as measured by Number of new or revised learning offerings <i>Baseline: 5 in 2010</i> <i>Target: 10 in 2014</i></p>	<p><b>Mostly Achieved.</b> A total of 9 (new and revised) learning offering were introduced. 6 new learning offers were made available to youth including arts and crafts, beauty care, bakery, culinary arts, commercial cooking, textile etc. 3 new credit courses (academic, analytical and entrepreneurship) were launched at the Royal University of Bhutan in addition to modernization of training infrastructure through the videoconferences facilities and the Virtual Learning Environment Competitive selection of private training institutes accomplished (for 6 selected institutes) 5 partnerships with private sector established. Challenges remain during the training period the MoLHR found that most young people are not willing to take up the skills development training. The uptake of the training has been slow and as a consequence had to motivate the youth to join and provide incentives (ex: stipends) and accepting everyone who applies (without screening)</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• IDF Grant MOLHR (completed)</li> <li>• PSD (completed)</li> <li>• EDP (completed)</li> <li>• DPC1 &amp; 2 (completed)</li> </ul> <p><b>Non-lending</b></p> <ul style="list-style-type: none"> <li>• HE Sector Note ESW (completed)</li> </ul>	<p>✓ Partnerships with the industry and academia outside Bhutan including via train the trainers programs proved critical to build capacity/standards among the local training private sector, train and employ Bhutanese candidates abroad with a view to deploy some in Bhutan and new curriculum at RUB.</p>



CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
<p><b>Outcome 6:</b> Increased number of graduates trained through public private partnerships (e.g. tourism, ICT, nursing)</p> <p><i>Baseline: 20</i> <i>Target: 1,000</i></p>	<p><b>Achieved.</b> <b>Target has been exceeded.</b> 1,372 secondary and tertiary graduates have been trained. Training for skills development through PPP has progressed well with about 100 youth trained or in training. Number of Bhutanese graduates working in the IT/ITES and related sectors of the economy is 1,015 which is 15 percent of the total unemployed and 29 percent of unemployed youth in Bhutan.</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• IDF Grant MOLHR (completed)</li> <li>• PSD (completed)</li> <li>• EDP (completed)</li> <li>• DPC1 &amp; 2 (completed)</li> </ul> <p><b>Non-lending</b></p> <ul style="list-style-type: none"> <li>• HE Sector Note ESW (completed)</li> </ul>	<ul style="list-style-type: none"> <li>✓ Output based matching grants to private sector training firms (subsidy commensurate to percentage of employment of trained candidates) were successful-at this private sector led training approach is being adopted by RGoB in many sectors changing their overall vocational training.</li> <li>✓ The program not only catered the university graduates, secondary graduates were more in demand of the vocational training received and well suited for employment after receiving on the job training.</li> <li>✓ Support led to the observation that technical and vocational training is an area for WB and IFC to leverage each other.</li> </ul>
<b>Results Cluster 3: Sustainable Urban Rural Development</b>			
<p><b>Outcome 7:</b> Improved management of the natural capital and strengthened resilience to climate change/Disaster Risks in selected Thimphu local areas plans (LAPs) as measured by access to roads, water and sewage</p> <p><u>Roads</u> <i>Baseline: 0</i> <i>Target: 200 plots / 12km roads constructed</i></p> <p><u>Piped Water</u> <i>Baseline: 0</i> <i>Target: 150 households</i> <i>(Target has been revised to 150 households)</i></p> <p><u>Sewerage</u> <i>Baseline: 0</i> <i>Target: 150 households</i> <i>(Target has been revised to 150 households)</i></p>	<p><b>Mostly Achieved.</b></p> <p>300 plots are completed which is higher than the target of 200 plots. 6.3 km of roads have been constructed.</p> <p>100 households have been connected to new piped water and sewerage connection which is lower than the target of 150. Civil works in the two local area plans (LAPs) are ongoing and the remaining targets are expected to be achieved by early part of the CPS. In the first LAP (Dechencholing), there were delays in commencing implementation following procurement/selection issues. There were slippages in maintaining the construction work plan due to various local factors (e.g. availability of adequate labor at times, the Indian Rupee crisis and also lack of capacity at Thimphu</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• BUDP2</li> <li>• DPC1 &amp; 2 (completed)</li> </ul> <p><b>Non-lending</b></p> <ul style="list-style-type: none"> <li>• Construction Sector Assessment ESW</li> <li>• Poverty Mapping TA (completed)</li> <li>• Disaster Management TA (Completed)</li> <li>• Tax Administration TA</li> </ul>	<ul style="list-style-type: none"> <li>✓ One of the main implementation challenges was lack of adequate technical capacity in implementing agency with the main impediment being inadequate contract management and lack of supervision to ensure quality of works.</li> <li>✓ With rapid urbanization in Bhutan, the need to meet the growing demands for urban services and the concomitant infrastructure requirements will be of high priority. Coupled with institutionalization of improved municipal management and governance, the path could be paved for sustainable urban development.</li> <li>✓ Among with the provision of improved urban service delivery, the institutionalization of municipal finance reforms and urban management in the Thromdes needed.</li> <li>✓ Given the constrained capacity of the Thromdes, provision for international and</li> </ul>

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
	Thromde for contract management and supervision works.		/or highly skilled national engineers need to be made for timely preparation and implementation of components in urban infrastructure as well as in municipal management may be necessary.
<p><b>Outcome 8:</b> Improved management of municipal services and finance as indicated by (a) increased collection of property taxes as measured by the percentage of the total due to be collected, and (b) increased cost recovery for municipal services as measured by charges/costs received as a proportion of total costs incurred in the provision of municipal services</p> <p><u>Property taxes</u> Baseline: 45 percent Target: 70 percent</p> <p><u>Municipal services</u> Baseline: 40 percent Target: 60 percent</p>	<p><b>Partially Achieved.</b> The draft Municipal Finance Policy has been approved in July 2012. The work on initial stages (digitization of tax and non-tax records and asset register) has been completed. About 6000 tax records(4,500 in Thimpu and 1,500in Phuentsholing) have been digitized in Thimpu Thormodes. Work on improving revenue administration (through specific guidelines and manuals) and re-engineering the business processes of tax collection is about to commence. Improvements of collection rates are expected to increase after both these components are implemented.</p> <p>The property tax records computerization is underway and training courses on Fiscal Decentralization have been given to the technical staff. However, much work is still needed to meet the CPS target. For example: revenue database and asset digitization is still under progress. A revenue enhancement system is now in place but there are still some technical issues to address.</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• BUDP2</li> <li>• DPC1 &amp; 2 (completed)</li> <li>• Strengthening Intergovernmental fiscal framework (IDF)</li> </ul> <p><b>Non-lending</b></p> <ul style="list-style-type: none"> <li>• Construction Sector Assessment ESW</li> <li>• Poverty Mapping TA (completed)</li> <li>• Disaster Management TA (Completed)</li> <li>• Tax Administration TA</li> </ul>	<ul style="list-style-type: none"> <li>✓ One of the main implementation challenges was lack of adequate technical capacity in implementing agency with the main impediment being inadequate contract management and lack of supervision to ensure quality of works.</li> <li>✓ With rapid urbanization in Bhutan, the need to meet the growing demands for urban services and the concomitant infrastructure requirements will be of high priority. Coupled with institutionalization of improved municipal management and governance, the path could be paved for sustainable urban development.</li> <li>✓ Among with the provision of improved urban service delivery, the institutionalization of municipal finance reforms and urban management in the Thromdes needed</li> </ul>
<p><b>Outcome 9:</b> Improved access to markets through: (i) the establishment of community groups for road maintenance as measured by the number of community groups, and (ii) the construction of new farm roads as measured by kilometers of new roads</p> <p><u>Community groups</u> Baseline: 0 Target: 80</p> <p><u>Roads</u> Baseline: 0</p>	<p><b>Mostly Achieved.</b> 95.5 km of farm roads constructed. A further 18 km of new rural roads have been identified. 100 percent targeted feeder roads constructed. 100 percent targeted feeder roads improved to all season standards.</p> <p>The CPS program was not clear about identifying the right indicator and did not revise the indicator during the progress report. However the Bank's ongoing program has involved communities in</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• DRDP</li> <li>• RAP2</li> <li>• DPC1&amp;2</li> <li>• Rural Communities</li> </ul> <p><b>Non-lending</b></p> <ul style="list-style-type: none"> <li>• Urbanization and Growth Study ESW (Dropped)</li> <li>• HD PER ESW(Completed)</li> <li>• Youth Employment Study ESW (Dropped)</li> <li>• Rural Development</li> </ul>	<ul style="list-style-type: none"> <li>✓ Some challenges remain in implementing program like labor shortage, low capacity at the dzongkhag and geog level, low capacity at the project management team, and shortage of qualified local contractors, technical specialists and engineers.</li> <li>✓ There should be focus on agricultural job creation and retention especially for youth. Continued focus on innovation, productivity and mechanization is needed.</li> </ul>

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
<i>Target: 80 km</i>	identifying community infrastructure. Therefore, by virtue of constructing the farm road through the CPS programs have led to better access to markets, reduced transportation costs and access to agricultural services.	Strategies ESW (dropped) <ul style="list-style-type: none"> <li>• Poverty Mapping ESW(Completed)</li> </ul>	
<b>Outcome 10:</b> Share of beneficiaries with access to critical community infrastructure increased as measured by: Improved source of drinking water Baseline: 66% (2012) Target: 68% (2014) Sanitation: Baseline: 43% (2012) Target: 45% (2014)	<b>Not Achieved.</b> The program to achieve the outcome has recently been effective and it is too early to show any significant result. The project is currently undertaking participatory implementation plan to assess the need and districts where the drinking water and sanitation services intervention will be implemented.	<b>Lending:</b> <ul style="list-style-type: none"> <li>• DRDP</li> <li>• RAP2</li> <li>• DPC1&amp;2</li> <li>• Rural Communities</li> </ul> <b>Non-lending</b> <ul style="list-style-type: none"> <li>• Urbanization and Growth Study ESW (Dropped)</li> <li>• HD PER ESW(Completed)</li> <li>• Youth Employment Study ESW (Dropped)</li> <li>• Rural Development Strategies ESW (dropped)</li> <li>• Poverty Mapping ESW(Completed)</li> </ul>	✓ Future CPS should consider identifying outcomes which can only attribute during the CPS cycle. The program which will be implemented during the end of the CPS period should not be considered achievable during the CPS period.
<b>Outcome 11:</b> Improved capacity of key RoGB agencies for DRM  Baseline: 0 (2012) Target: 4 Ministries (2014)	<b>Achieved.</b> The activities under the grant has helped improve the capacity of key DRM focal persons across all government agencies such as Ministry of Home and Cultural Affairs, Ministry of Education, Ministry of Health, Ministry of Works and human Settlement, Thimpu Thromde, National Land Commission.	<b>Non-lending</b> <ul style="list-style-type: none"> <li>• JSDF Seed Fund for “Building climate and disaster resilient communities in Bhutan” proposal. (Dropped)</li> <li>• Proposed JSDF project for “Building climate and disaster resilient communities in Bhutan”. (Dropped)</li> <li>• GFDRR TA for Bhutan Disaster Risk and Recovery Program)</li> <li>• GFDRR-GHI Partnership for Safe Schools and Hospitals</li> <li>• GFDRR “Improving Disaster Management Capacity in Bhutan Japan Policy and Human Resources Development</li> </ul>	✓ Disaster Management requires the involvement of various Departments under different ministries and the main challenge is the lack of coordination and communication among various agencies with similar objectives and relatively weak technical capacities of government counterparts.  ✓ A specific challenge to implementation was related to the hiring of a Bhutanese lawyer to support the DDM in developing Rules and Regulations to operationalize the new legislation. Challenges were due to: (i) the current consultant fee matrix for Bhutan whose rates for senior consultants does not allow hiring local consultants with adequate skills and experience; (ii) the dispersal of internal fiduciary and processing responsibilities which results in delays for most business process.

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
		(PHRD) TA Program to Support Disaster Reduction and Recovery.	<p>✓ The need to seek support and guidance from other country offices on resource management: procurement, disbursement, accounting and other logistics leads to a lot of back and forth discussions which lead to delay in delivering at times. This also hinders our support for support for some of the activities proposed by the government.</p> <p>✓ The final draft of the rules and regulations to support the implementation of DM Act 2013 is in place.</p>
<p><b>Outcome 12:</b> Improved institutional set up for Disaster Management for the implementation of the DM bill through development of guidelines and sensitization workshops Baseline: 0 (2012) Target: 4 Ministries (2014)</p>	<p><b>Achieved.</b> Completed the first training on Basic Urban Search and Rescue to the National Search and Rescue Team and rolling out of trainings in municipalities and selected district level. Capacity building program for seismic engineering has been completed, including the development and piloting of a vulnerability assessment checklist for schools and hospitals. A technical assistance program (TAP) for piloting the use of probabilistic risk assessment has been completed. Completed the vulnerability assessment form for schools and hospitals and conducted the first training to the Engineers from the key agencies on the concepts and use of the form</p>	Same as outcome 11.	Same as above.
<p><b>Outcome 13:</b> Finalized and approved National Action Plans for schools and hospitals. Baseline: No action plan Target: Action plan finalized and approved.  Completed training program for national search and rescue team</p>	<p><b>Achieved.</b> A National Action Plan for both Schools and Hospitals have been completed and approved by the relevant authorities. The next step includes roll out of the nationwide vulnerability assessment of all schools and basic health units.</p>	Same as outcome 11.	Same as above
<b>Results Cluster 4: Access to Quality Public Service</b>			
<p><b>Outcome 14:</b> Improved allocation of resources in social sectors as evidenced by development of MYRBs</p>	<p><b>Achieved.</b> MYRB and Public Expenditure Management Systems (PEMS) have been rolled out across all spending agencies which now capture all of</p>	<p><b>Lending:</b> • DPC1 &amp; 2 (completed) <b>Ongoing/Completed AAA</b> • Poverty Mapping</p>	<p>✓ Good governance is one of the key priorities for RGoB and strengthening the PFM system is important. An MDTF for PFM strengthening can be established</p>

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
<p><i>Baseline: 0</i> <i>Target: 2 sectoral MYRBs developed</i></p>	<p>RGoB budget implementation. The web based financial reporting tools for budget and expenditure (MYRB and PEMS) are now integrated and well-coordinated within the sectoral ministries.</p> <p>HD Public Expenditure Review has been completed. Several sector studies including National Health Accounts, Costing of Public Health services and GIS based study on health infrastructure and indicators were undertaken for the first time and have provided much needed evidence for informed policy making. Local level indicators have been used increasingly for planning and resource allocation purposes of RGOB and the poverty maps at the gewog (sub-district) level have been used to determine allocations under the annual capital grant. The second phase of poverty mapping exercise provided a broader range of disaggregated indicators at the gewog level, through the Bhutan Map Portal, which is hosted and maintained by the NSB.</p>	<p>ESW(completed)</p> <ul style="list-style-type: none"> <li>• HD PER ESW (completed)</li> <li>• HE Sector Note ESW (completed)</li> <li>• Rural Development Strategies ESW</li> <li>• Construction Sector Assessment ESW</li> <li>• Management of Hydropower Revenues TA</li> <li>• MTFE and MYRB TA</li> <li>• Public Financial Management Report ESW</li> </ul>	<p>and implementation of the PFM reform program from budget preparation to legislative oversight can be supported through the MDTF.</p> <ul style="list-style-type: none"> <li>✓ Constant follow up and monitoring of these activities are important. It is important to have formal commitment from the client side before engaging to any project.</li> <li>✓ While MYRB and PEMS are well coordinated but same is not the case for performance measurement (PlaMS). This integration should ideally result in an overarching monitoring and evaluation framework for the country with linkages between financing and performance of social sector ministries.</li> </ul>
<p><b>Outcome 15:</b> Service delivery standards and criteria in place as evidenced by annual reporting to the National Assembly</p> <p><i>Baseline: not reported</i> <i>Target: reported</i></p>	<p><b>Achieved.</b></p> <p>Service delivery standards have been developed and reported to national assembly in all ministries, twelve autonomous agencies and twenty dzongkhangs for priority services.</p>	<p><b><u>Lending:</u></b></p> <ul style="list-style-type: none"> <li>• DPC1 &amp; 2 (completed)</li> </ul> <p><b><u>Ongoing/Completed AAA</u></b></p> <ul style="list-style-type: none"> <li>• Poverty Mapping ESW(completed)</li> <li>• HD PER ESW (completed)</li> <li>• HE Sector Note ESW (completed)</li> <li>• MTFE and MYRB TA</li> <li>• Public Financial Management Report ESW</li> </ul>	
<p><b>Outcome 16:</b> Identification of strategic partnerships with outside tertiary education institutes</p> <p><i>Baseline: 2</i> <i>Target: 6</i></p>	<p><b>Not Achieved.</b></p> <p>This outcome was not achieved as the intended project was postponed to let the previous project mature and yield lessons. Though some work on the theme was undertaken as part of the Higher Education AAA, this outcome required much more than what could have been achieved through only analytic work.</p>	<p><b><u>Lending:</u></b></p> <ul style="list-style-type: none"> <li>• EDP</li> <li>• DPC 1 &amp; 2 (completed)</li> </ul> <p><b><u>Ongoing/Completed AAA:</u></b></p> <ul style="list-style-type: none"> <li>• HD PER(Completed)</li> <li>• HE Sector Note(completed)</li> </ul>	

CPS Outcomes & Indicators	Status and Evaluation Summary	Lending and Non-Lending Activities that Contributed to the Outcome	Lessons and Suggestions for the next CPS
<p><b>Outcome 17:</b> Quality assurance system in RUB established as measured by the number of programs and degrees covered  <i>Baseline: 2</i>  <i>Target: 6</i></p>	<p><b>Partially Achieved.</b>  Higher Education Policy Note and the findings from the report informed the RGoB in the preparation of the Quality Assurance and Accreditation Framework. The Government found the recommendation very helpful and prepared a Quality Assurance and Accreditation Framework (QAA). The study also directly fed the Public Expenditure Review in the human development areas.</p>	<p><b>Lending:</b></p> <ul style="list-style-type: none"> <li>• EDP</li> <li>• DPC 1 &amp; 2 (completed)</li> </ul> <p><b>AAA:</b></p> <ul style="list-style-type: none"> <li>• HD PER(Completed)</li> <li>• Higher Education Sector Note(completed)</li> </ul>	
<p><b>Outcome 18:</b> Raising awareness of health and nutrition issues measured by some recommendations made in the Bank’s analytic work reflected in the upcoming Government’s 11<sup>th</sup> 5 year plan.</p>	<p><b>Achieved.</b>  Analytical work carried out on health and nutrition and widely discussed in the high level workshops have been well received and also attracted top levels policy as well as the country’s media. The Government’s 11 five year plan highlights nutrition very prominently. Actual implementation of the policy notes is only now taking place and the Bank will continue to supporting the work so far has ensured that this remained at the center stage of policy makers attention and plans.</p>	<p><b>AAA:</b>  Bhutan National Nutrition Assessment and Gap Analysis  HD PER  Health analytic pieces including Bhutan’s first National Health Accounts (NHA) estimates, a costing study of health facilities, and a study on health indicators</p>	<p>Government capacity constrained in a small country context, linked with rapid turnover in officials, limited the availability of information and also created challenges for sustained government interest in taking forward the recommendations of the analytical work.  Future CPS program should continue to work with the Government and development partners for operationalizing the recommendations from the analytical work closing any vital data gaps. This would enable, engaging policy dialogue and being opportunistic to support the country in sustaining its gain in the health and education sectors. The possible focus areas in health would be an under-nutrition, sustainable health financing, reforming human resource assignment based on requirements rather than inflexible staffing norms, exploring performance based remuneration mechanisms for health professional and workers.</p>

### Annex 3 B: Bhutan CPS Planned Lending Program and Actual Delivery

FY	CPS Plans	Million(US\$)		Status	Million (US\$)	
		IDA	TF		IDA	TF
2011	DPC 1	24.75		DPC 1	24.75	
	Regional Wildlife	0.75		Regional Wildlife	2.25	
				Improving Statistical Capacity		0.3
				Additional Financing for Decentralized Rural Development		5
2012	Improving Rural Livelihoods	12		Thimpu Strategic Cultural Heritage and Sustainable Tourism		
2013	DPC 2	20		DPC 2	36	
	PSD/Knowledge Society	8		Remote Rural Communities Development	9	
				Improving Resilience to Seismic Risk		1.3
				Sustainable Financing for biodiversity conservation		4.1
2014	Urban Development 3	12.45		Urban Development Additional Financing	17	

**Table 3: Bhutan CPS Non-Lending Services and Actual Delivery**

FY	CPS Planned	Status	
2011	HD Public Expenditure Review (ESW)	Delivered FY 13	
	Bhutan Investment Climate Follow-Up (TA)	Delivered	
	Higher Education Policy Note (ESW)	Delivered FY 13	
	Solid Waste Management in Thimpu (TA) (IFC-Bank)	Dropped	
	Poverty Mapping (TA)	Delivered FY12	
	Advisory on Licensing Simplification (IFC)	Ongoing	
	E-Governance (TA)	Delivered FY12	
	JSDF Seed Fund for 'Building Resilience of Communities Against Disasters and Climate Change'	Not Delivered.	
	Thimphu Parking Project TA (IFC)*	Ongoing	
	Access to Finance TA to Banks (IFC)	Ongoing	
	SME/Finance TA (IFC)*		
	Disaster Risk and Recovery Program (GFDRR grant)		
	<b>New AAA/NLTA FY II:</b>		
	NLTA to ICT Sector	Delivered	
	Urban Transport (IFC-PPP)		
	PFM Improvement (IDF)	Delivered	
2012	Youth Employment Study ESW	Not Delivered	
	DPC 2 related AAA	Delivered	
	Access to finance advisory (WB-IFC)	Ongoing	
	Building Public-Private Partnerships (TA)	Delivered	
	Rural Development Strategies (ESW)	Dropped	
	Medium-Term Fiscal Framework / MYRB (TA)		
	ICT Sector Policy and Regulatory Issues (TA)	Delivered	
	Country Sustainable Development Analysis (ESW)	Dropped	
Auditing and Accounting (TA)	Delivered		

	Decentralization and Sub-National Strengthening (TA)	Dropped
	Agricultural Marketing Study	Dropped
	<i>New AAA/NLTA:</i>	
	Improving Capacity of the Government to implement infrastructure PPPs	Delivered
	Telecom sector roadmap	Delivered
	Developing and Strengthening the Regulatory Framework for Pension, Provident Fund and other such schemes in Bhutan (TA)	
	NLTA to ICT Sector	Delivered
	E-Government Follow-Up TA	Delivered
<b>2013</b>	Public Procurement (IDF)	Ongoing
	Poverty Assessment (ESW)	Delivered FY14
	Construction Sector (ESW)	Dropped
	National Transport Plan (ESW)	Dropped
	Disaster Risk Management TA	Delivered
	Tax Administration (TA)	Dropped
	Urbanization and Growth Study (ESW)	Dropped
	JSDF support for ‘ Building Resilience of Communities Against Disasters and Climate Change’	Dropped
	<i>New AAA/NLTA:</i>	
	Financial Inclusion Focus Group Survey (just in time AAA)	Delivered
	Gender Policy Note	Delivered
	Improving Statistical Capacity (TA)	Delivered
	Bhutan Disaster Risk & Recovery	Delivered
	Policy & Regulatory Assistance to MOIC	Delivered
	Social Development & Cultural Heritage	Delivered
	PFM Strengthening IDF	Ongoing
<b>2014</b>	Management of Hydropower Revenues (TA)	
	Decentralization (TA)	
	Corporate Governance (TA)	Ongoing
	Environmental Safeguards (IDF)	Delivered FY12
	<i>New AAA/NLTA:</i>	
	Institutional Strengthening of the Ministry of Labor and Human Resources	Delivered
	Bhutan National Nutrition & Gap Analysis (ESW)	Delivered
	Green Growth Policy Note Bhutan	Delivered
	Bhutan Doing Business Reform TA	Ongoing
	PSIA of Bhutan Heritage Sites Act	Delivered
	Study: Methods for Works Bids Bhutan	Ongoing
	Financial Sector Review (TA)	Ongoing
	Capacity to implement infrastructure PPPs Phase 2	Ongoing



## Annex 4: Bhutan Status of Millennium Development Goals

1. As shown in the table below, Bhutan is on track to achieving most of the Millennium Development Goals (MDG) targets by 2015 at the national level. The country is committed to achieving the MDGs, which fits within the framework of Bhutan's overarching development philosophy of Gross National Happiness (GNH). Gross Primary enrolment rate and access to safe drinking water and improved sanitation facilities have been achieved seven years ahead of the 2015 target year. The remaining MDGs and targets are expected to be achieved by 2015, with the exception of four targets that are currently off track and require further attention and acceleration plans to ensure they are met by 2015.

2. These off-track targets are:

- i. *Proportion of population below minimum level of dietary energy consumption* - although more recent data will probably show an improvement (the most recent information is from 2007). Nutrition indicators, although better than for Bhutan's South-Asian neighbors and improving, remain a cause of concern. The bottom 40 percent of the population had about 40 percent of children under-five stunted and 15 percent undernourished. The under-nutrition is prevalent in the eastern part of the country and among children of mothers with no-education.
- ii. *Ratio of females to males in tertiary education* - Bhutan has made definite improvement in terms of promoting gender equity and women empowerment but critical issues remain. Lower access of female to more productive employment opportunities, and lower share of women in non-agricultural wage employment, declining share of women in leadership positions still reflect large gender disparities. Strengthening of gender mainstreaming efforts remains paramount.
- iii. *HIV cases detected and contraceptive prevalence rate* - Rising cases of HIV/AIDS is an emerging challenge. The number of HIV/AIDS cases detected in Bhutan is increasing every year since 1993, when the first case was detected. In 2013, officially reported cases of HIV/AIDS are 321. 20% of the HIV/AIDS cases detected belong to the age group 15-24 years. Since 30% of the cases of HIV/AIDS are housewives, the risk of its spread to next generation is also high. The current surviving cases of HIV/AIDS are 249. The cases of HIV/AIDS have increased alarmingly since 2000. However, the HIV prevalence rate is less than one percent (0.01%) of the total population. A combination of factors like limited knowledge about HIV/AIDS, lower contraceptive prevalence rate and high adolescent birth rates makes younger age group more vulnerable.
- iv. *Youth unemployment rate* - Youth unemployment is increasingly considered to be a challenge. It stood at 9.6 percent in 2013, and is on the rise. This calls for provision of decent employment opportunity, private sector development and enhancement of skills so as to increase the productivity of labor.

Goal / Target / Indicator	1990*	2000	2012	Target 2015	Status
<b>GOAL 1 : ERADICATE EXTREME POVERTY AND HUNGER</b>					
Proportion of population below the national poverty line (%)		36%	12%	20%	Achieved
% of pop. below minimum level of dietary energy consumption		3.8%	5.9%	1.9%	Off track
% of under-weight under-five children	38%	19%	12.70%	19%	Achieved
% of under-height under-five children	56%	40%	33.50%	28%	On track
<b>GOAL 2 : ACHIEVE UNIVERSAL PRIMARY EDUCATION</b>					
Net primary Enrolment ratio		62%	96%	100%	On track
Proportion of pupils starting grade 1 who reach grade 5	73%	91%	100%	100%	Achieved
Proportion of pupils starting grade 1 who reach grade 7	35%	81%	98%	100%	On track
<b>GOAL 3 : PROMOTE GENDER EQUALITY AND EMPOWER WOMEN</b>					
Ratio of girls to boys in primary education	69%	82%	99%	100%	Achieved
Ratio of girls to boys in secondary education	43%	78%	107%	100%	Achieved
Ratio of females to males in tertiary institutes	12%	41%	71%	80%	Off track
<b>GOAL 4 : REDUCE CHILD MORTALITY</b>					
Under-five mortality ratio (per 1000 live births)	123	84	69	41	On track
Infant mortality ratio (per 1000 live births)	90	60.5	47	30	On track
Proportion of children covered under immunization program	84%	85%	94%	>95%	On track
<b>GOAL 5 : IMPROVE MATERNAL HEALTH</b>					
Maternal mortality ratio (per 100,000 live births)	560	255	155	140	On track
Births attended by skilled health personnel	15%	24%	69%	100%	On track
<b>GOAL 6: COMBAT HIV-AIDS, MALARIA AND OTHER DISEASES</b>					
HIV cases detected	0	38	297		Off track
Contraception prevalence rate	19%	31%	65.60%	60%	Achieved
No. of malaria cases & incidences (cases per 100,000)	3,687	875	194		On track
No. of tuberculosis cases & incidences (cases per 100,000)	720	168	1250		On track
<b>GOAL 7: ENSURE ENVIRONMENTAL SUSTAINABILITY</b>					
Proportion of land area covered by forest	72.50%	72.50%	81%	60%	Achieved
Ratio of protected area to surface area for maintaining biological diversity	23%	26%	28%		On track
CO2 (per capita) emission		7.9 mt	n.a.		On track
Proportion of population using solid fuels (wood, charcoal & dung)		75%	28.6		On track
Proportion of population without sustainable access to an improved water source	55%	22%	9.7%	27.5%	Achieved
Proportion of population without access to improved sanitation	33%	12%	5.5%	17.5%	Achieved
Youth unemployment	2.6%		7.3%		Off track

## Annex 5: Poverty and Shared Prosperity

- 1. Bhutan's poverty reduction has been rapid, broad-based, and inclusive.** Between 2007 and 2012, the percentage of consumption poor halved to 12 percent. Bhutan has nearly ended extreme poverty<sup>43</sup> within the living memory of a generation – extreme poverty touched a low of 2 percent in 2012. Broader multidimensional poverty indices, that include education and health outcomes besides standards of living, also indicate a steep decline in the percentage of deprived population –by two-thirds, from 30 percent to 10 percent. Growth in Bhutan has been pro-poor in a substantive way –not only has the headcount poverty rate declined, but the poverty gap also declined across all the poverty bands. Prosperity has been widely shared among all income classes, with the bottom 40 percent of the population enjoying faster growth than the rest, save for the top 10 percent. Inequality remained stable, allowing the full effect of growth on poverty reduction.
- 2. Yet some have stayed poor and some non-poor fell into poverty.** The rapid reduction in poverty bypassed nearly half of those found to be poor in 2007. Further, notwithstanding the cherished community support, families do fall through cracks: for every two families that managed to escape poverty, one previously non-poor family fell into poverty. Though mobility of the poor in Bhutan is one of the better international examples, there is room for reducing vulnerability of the poor and near-poor. The risk of falling back into poverty is greatest for Bhutanese in rural areas, those holding informal jobs, with low education, and resident especially in Pema Gatshel, Trashigang, or Dagana.
- 3. Food security improved in terms of access, but the poor still lag behind.** On average, Bhutanese increased dietary diversity by consuming from 10 food groups (out of 12) in 2012, from just seven groups in 2007. Protein sources, especially, have increased to include meat, fish, and pulses. However, the poor lag behind in access to diversified food groups, particularly protein sources. In addition, inadequate food is reported by 10 percent of poor households – more than double the non-poor's 4 percent.
- 4. Female-headed households are not on par with male-headed households in enjoying fruits of growth.** Thirty percent of Bhutanese households are headed by females. While the poverty incidence (consumption or multidimensional) poverty rate is found to be equal for both male- and female-headed households, some female groups (notably married and divorced) have a greater incidence of poverty than the corresponding male groups; the bottom 40 percent of female-headed households enjoyed a smaller rise in consumption compared to that of their male-headed counterparts. The persistence of the livelihood handicap for female-headed households, despite matrilineal inheritance and a non-discriminatory labor market, suggests that disproportionate household burdens may be diminishing opportunities for women.
- 5. Opportunities for children are equalizing regardless of birth circumstances but inequities in completion of secondary education persist.** Bhutanese children have better and improving opportunities in education and infrastructure services than those of other South Asian countries, and these opportunities are becoming more equal across income classes. The public policy of extending coverage for all and targeting interventions with electricity and gas provision have narrowed inequalities among children. Nevertheless, it is important to note that inequity in completion of secondary education remains an issue—the inequality-adjusted completion rate

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<sup>43</sup> Based on a consumption poverty line of US\$1.25 per capita per day in purchasing power parity terms.

was only 32 percent in 2012, with an adjusted attendance of 84 percent. Higher completion rates alone would help to build comparative advantage for Bhutanese youth in skilled labor.

6. **The main drivers of prosperity in rural Bhutan appear to be increasing commercialization of agriculture, an expanding rural road network, and beneficial spillovers from hydroelectric projects.** Helped by the recently renewed free trade agreements with India and preferential market access to Bangladesh, Bhutanese agricultural exports of commercial crops (notably oranges, cardamom, potatoes, and apples) have increased sharply. Increasing trade has been pro-poor. The eight-fold expansion in farm roads and progressive construction of highways linking with the Southern East-West highway, that runs along the Indian border, and new north-south links have all helped to create construction jobs and lowered the travel time and costs for goods and people. The four hydroelectric projects that began construction in the last five years (adding 3 GW to the current 1.6 GW generation capacity) are spreading good spillovers by expansion in roads, jobs, and business in the project areas. Individuals in lower economic deciles have reaped better rewards for their education and land. Land gift under the Royal *kidu* program may have also helped the previously landless to escape poverty. Education appears to be the most important route by far to escape poverty.
7. **The current pace of poverty reduction appears sustainable in the medium term.** Trade intensification with neighbors is set to continue, road infrastructure is poised for more expansion, and more hydroelectric project construction is planned to continue to 2020; the current free trade agreement with India, due for renewal in 2016, is most likely to be renewed. The bilateral agreement with Bangladesh, that has benefited Bhutan by preferential duty-free access to 74 mostly agricultural exports, is also due for renewal, in 2018. In addition bilateral agreements with Thailand and Nepal are also on the anvil. Bhutan is a net exporter of fruits and cardamom in the north-east region of the Indian sub-continent and should be able to sustain fruit exports to Bangladesh even with future preference erosion under the South Asian Free Trade Agreement (SAFTA). Growth dynamism in India and Bangladesh should be able to further accommodate expansion of differentiated agricultural exports from Bhutan which are well known for superior quality. Completion of the Southern East-West highway in Bhutan and expansion of the rural roads network would help to draw out the comparative advantages of Bhutanese agriculture. The hydroelectric projects now under construction are expected to continue to 2016/17, and more projects are planned that would continue to boost rural incomes indirectly. Despite rapid urbanization – one percent of rural population moving every year to urban areas – urban poverty has remained under 2 percent, indicating that migration is not biased particularly to the poorer sections of the society.
8. **For sustained poverty reduction, risks and vulnerabilities need to be managed carefully.** With limited land, increasing fragmentation of land holdings, and rural-to-urban migration of working age adults, labor-intensive horticulture will become increasingly difficult. Contract farming by large-scale land owners may be a way to sustain exports but benefits to poorer farmers might diminish. The current problems faced by farmers such as the incurable “greening disease” of oranges, diseases of the cardamom plants and regular raids into farms by elephants (in low land), monkeys, and wild boars have persisted. The plan for introducing disease-resistant cultivars is not proceeding swiftly. It takes years to bring horticultural crops to harvest and equally long to shift to other profitable forms of production. As a consequence of increasing commercial crop production, Bhutan dependence on food imports has been rising over the years, making it more vulnerable to food price shocks. A 12 percent increase in food prices – the average annual increase in recent years - for example, can increase the percentage of poor in the

short-term by about 2 percent points. With all petroleum products imported, Bhutan's poor also face risk from fuel price shocks. A sharp rise in the consumer prices of LPG and kerosene of the order that occurred in July 2013 (quickly reversed, however) had the potential to push 0.5 percent of population into poverty. Bhutan's social protection is mainly through the Royal *Kidu* welfare programme. Risks of downward mobility are greater than average for rural residents, male-headed households, people in informal jobs (the casually and self-employed), and those with low education and particularly high for those living in select *dzongkhags* such as Pema Gatshel, Dagana, Samtse, Trashigang, and Tsirang).

9. **Formal social protection programs may be necessary to help individuals cope with adverse economic and financial shocks.** At present, individuals cope with shocks mostly by drawing on own savings if they are non-poor, or by borrowing from friends, suppliers, and money-lenders if they are poor. Because of the inadequacy and inelasticity of these sources for the poor and vulnerable segments of the population, we suggest the introduction of formal social protection mechanisms and possibly well-targeted micro-credit programs.
10. **In the long-term, sustainable poverty reduction depends on addressing persistent shocks, engendering private sector led development and defining clear target groups for poverty reduction.** The feasibility of crop insurance for farmers may be examined to protect the harvests from perils of diseases. Other perils, such as those associated with wild-life predation, have also persisted and evaded viable solutions. What poor people want to better their living standards in the long term can be summed up as access to roads, electricity, public transportation, irrigation, land and higher education. Sustained poverty reduction depends on job opportunities and wage earnings of the poor. The development paradigm for a renewable resource rich country like Bhutan would call for engendering private sector led growth actively enabled by the public sector. The Royal Government of Bhutan seems to favor complementary use of consumption and multidimensional poverty. But the overlap of the two approaches identifying the poor is small. Therefore defining a clear target group for poverty reduction is important. Also, with success in reducing extreme consumption poverty rapidly, the goal could be now be shifted to shared prosperity defined for example as the welfare of the bottom 40 percent of the population.



## Annex 6: Gender Aspects in Bhutan

1. **Bhutan has undergone a major socio-economic transformation over the past few decades.** Today, as a middle-income country guided by the unique development philosophy of Gross National Happiness<sup>44</sup>, it continues to develop rapidly and become more integrated into the global economy. Coinciding with its development, Bhutan has also made considerable strides in closing gaps in gender equality. However, given that there are few deep-seated cultural restrictions, Bhutan also has the potential and ability to make even greater achievements in gender equality and be on par with leading nations of the world. In addition, domestic violence remains an important issue.

2. In Bhutan, most women acquire land ownership through inheritance, particularly in matrilineal communities. Unlike in other countries, the matrilineal inheritance practice offers economic opportunities for Bhutanese women and contributes to their relatively equal status with men. Particularly in rural areas, land is important for both men and women as it confers direct economic benefits as a key input into production, and as collateral for credit that can be used for either consumption or investment purposes. To reap full economic benefits from land, it is also essential for women to have “agency” over land.

3. In terms of women’s economic empowerment, Bhutan has made tremendous progress in female labor force participation, but the quality of jobs for women is still an issue. Although women’s participation in the labor force has increased, it has not translated into improvements in employment quality. The Labor Force Survey shows that Bhutanese women work in lower quality jobs than men—women who earn income from work outside the home, their earnings are only 75 percent of men’s earnings. Not only would improving job quality and productivity for women enhance gender equality, but it also could contribute to economic growth.

4. Three main causes explain the gender gap in job quality: education endowment at the higher secondary and tertiary levels, sex segregation in the labor market, and gender roles in household chores and child care. What’s more, gender roles in household chores and childcare represent constraints to women’s opportunities at various stages of life in that they limit girls’ study time, affect career choice, and impede career advancement. On the other hand, perceptions about gender roles are changing; survey participants agreed that women should work outside the home and that men should play a greater role in child care.

5. Domestic violence prevalence is relatively high. A recent study on the ‘situation of violence against women in Bhutan’ by the National Commission for Women and Children (NCWC) reports that about 2 percent of women, aged 15 to 49 years, are likely to be sexually abused before the age of 15, and that 4 percent of women are likely to have their first sexual encounter before 15 years, of which more than half are likely to be coerced or forced. About three in ten women are likely to have their first marriage before the legal age of 18. In addition, tolerance to domestic violence seems to be high. 70 percent of women declare that they deserve beating if they neglect their children, argue with their partners, refuse sex or spoiled meals (The National Statistics Bureau’s Bhutan Multiple Survey 2010). To better address these issues, the Parliament passed in early 2014 a Domestic Violence Prevention Act.

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<sup>44</sup> For additional information on Gross National Happiness, including a description and methodology, see [CBS’s website](http://www.grossnationalhappiness.com/articles/).  
<http://www.grossnationalhappiness.com/articles/>

## **Promoting gender equality through WBG engagement**

- Agriculture: promotes the agency of women to use land could be further enhanced so that women could gain better access to finance and economic opportunities, thus improve agricultural productivity.
- Gender data are essential to design policies addressing gender equality, but gaps in gender data exist to varying degrees in thematic areas such as: economic structure, health, public life and decision making, human rights of women and children. Going forward, there will be a review of gender statistics in Bhutan for availability, timeliness and reliability as a part of the update of National Statistics Development Strategy. Activities aim at filling the gender data gaps include strengthening of existing indicators as a part of planned survey/census activities of National Statistics Bureau using annual labor statistics, conducting the population and housing census in 2015, and developing a new survey instrument to collect gender statistics in subsequent national household surveys.

## **Monitoring progress**

6. The new activity to improve gender statistics will strengthen Bhutan's capacity to monitor progress on gender equality. Gender relevant and sex-disaggregated indicators are also monitored in the CPS results framework.



## Annex 7: Selected Indicators of Bank Portfolio Performance and Management

Indicator	2012	2013	2014	0
<b>Portfolio Assessment</b>				
Number of Projects Under Implementation <sup>a</sup>	4	3	3	0
Average Implementation Period (years) <sup>b</sup>	4.7	1.3	2.3	0.0
Percent of Problem Projects by Number <sup>a, c</sup>	0.0	0.0	0.0	0.0
Percent of Problem Projects by Amount <sup>a, c</sup>	0.0	0.0	0.0	0.0
Percent of Projects at Risk by Number <sup>a, d</sup>	0.0	0.0	0.0	0.0
Percent of Projects at Risk by Amount <sup>a, d</sup>	0.0	0.0	0.0	0.0
Disbursement Ratio (%) <sup>e</sup>	30.8	40.1	38.4	0.0

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	18	5
Proj Eval by OED by Amt (US\$ millions)	170.4	60.3
% of OED Projects Rated U or HU by Number	16.7	40.0
% of OED Projects Rated U or HU by Amt	7.0	11.2

- a. As shown in the Annual Report on Portfolio Performance (except for current FY).
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

\* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.



## Annex 8: IDA Operations Portfolio

Closed Projects      22

**IBRD/IDA \***

Total Disbursed (Active)	11.98
of w hich has been repaid	0.00
Total Disbursed (Closed)	204.16
of w hich has been repaid	13.78
Total Disbursed (Active + Closed)	216.14
of w hich has been repaid	13.78
Total Undisbursed (Active)	26.62
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	26.62

**Active Projects**

**Difference Between  
Expected and Actual  
Disbursements**

Project ID	Project Name	<u>Implementation Progress</u>	Fiscal Year	IDA	GRANT	Undisb.	Orig.
P127490	BT; Biodiversiy Conservation	S	2013		4.1	3.1	-0.7
P123820	BT: Remote Rural Communities Development	S	2013	9.0		3.2	-4.0
P090157	BT: Urban Development II	MS	2010	29.4		23.4	-6.0
<b>Overall Result</b>				<b>38.4</b>	<b>4.1</b>	<b>29.7</b>	<b>-10.6</b>



## Annex 9: IFC Investment Operation Program

<u>FY Approval</u>	<u>Company</u>	<u>Committed</u>					<u>Disbursed Outstanding</u>				
		<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>	<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>
2013	Bnb	0	28.43	0	0	0	0	28.43	0	0	0
2004	Brpl	2.24	0	0	0	0	2.24	0	0	0	0
<b>Total Portfolio:</b>		<b>2.24</b>	<b>28.43</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>2.24</b>	<b>28.43</b>	<b>0</b>	<b>0</b>	<b>0</b>

\* Denotes Guarantee and Risk Management Products.

\*\* Quasi Equity includes both loan and equity types.



## Annex 10: Bhutan Active Recipient and Bank Executed Trust Fund

### Recipient Executed

Trust Fund #	Trust Fund Name	Grant Closing Date	Net Grant Amount (US\$ in thousand)	Fund Disbursement to Date
TF010597	Sustainable Financing for Biodiversity Conservation and Natural Resource Management	3/21/2014	130,000	130,000
TF011760	Thimphu Strategic Cultural Heritage and Sustainable Tourism Plan and Implementation of Priority Actions	6/30/2014	255,000	81,934
TF013185	Strengthening Public Financial Management in Bhutan	1/31/2016	550,000	334,320
TF014121	Bhutan - Improving Resilience to Seismic Risk	5/30/2017	1,285,500	167,866
TF014439	Strengthening Intergovernmental Fiscal Systems and Capacity Building	7/10/2016	290,300	27,884
TF014705	Sustainable Financing for Biodiversity Conservation and Natural Resource Management Project	12/31/2018	4,080,000	960,129
TF097102	IDF: Bhutan - Institutional Strengthening of the Ministry of Labor and Human Resources Project	1/7/2014	498,500	498,500
TF098505	Bhutan: Improving statistical capacity	10/31/2013	288,616	288,616
TF098827	Additional Financing for Bhutan Decentralized Rural Development Project	12/31/2014	5,000,000	4,929,544
TF098973	Strengthening Institutional Capacity of Druk Holding and Investments to Improve Corporate Governance of State-Owned Enterprises in Bhutan	5/17/2014	500,000	500,000

## Bank Executed

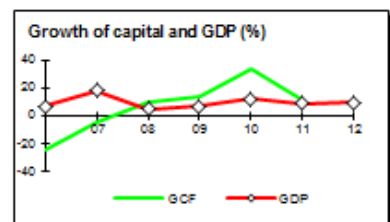
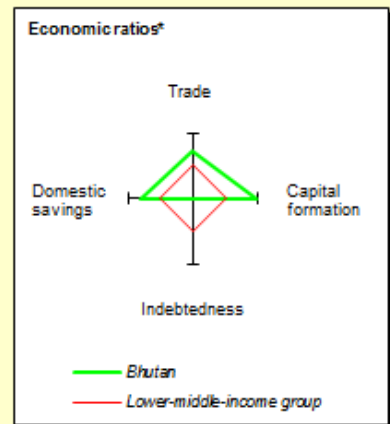
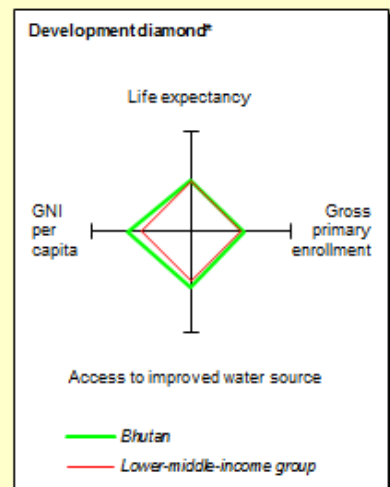
Trust Fund #	Trust Fund Name	Grant Closing Date	Net Grant Amount (US\$ in thousand)	Fund Disbursement to Date
TF011607	Bhutan gender policy note	12/30/2013	119,607	119,607
TF011758	Thimphu Strategic Cultural Heritage and Sustainable Tourism Plan and Implementation of Priority Actions	12/31/2014	45,000	33,100
TF012082	Bhutan National Nutrition Assessment	2/28/2014	119,704	118,997
TF013466	Bhutan: Diversification of Rural Livelihoods for Youth	10/31/2013	48,825	48,825
TF013492	Bhutan - BETF: Improving Disaster Management Capacity in the Kingdom of Bhutan (GFDRR: TK2 TA Core)	12/31/2014	440,000	233,476
TF014122	Bhutan - Improving Resilience to Seismic Risk (Bank Supervision)	5/30/2017	128,550	23,735
TF015785	Bhutan: Capacity Building in Municipal Finance	6/30/2014	49,000	47,600
TF016119	DRM - Strengthening Disaster Preparedness and Climate Resilience in Bhutan	6/30/2015	250,000	41,527
TF016705	Bhutan EV initiative	6/30/2015	200,000	50,434
TF016819	Bhutan #A060 Financial Sector Development Implementation Plan	8/31/2014	347,058	
TF017116	Supporting the development of Bhutan's Social Protection Strategy	6/12/2015	300,000	17,833
TF017250	BHUTAN: Improving Capacity of the Government to Implement Infrastructure PPPs (Phase II)	12/31/2015	244,410	
TF098087	Additional Financing for the Decentralized Rural Development Project (DRDP)	6/30/2015	120,000	58,102
TF099071	Bhutan HRBF K&L Grant	12/31/2014	100,000	65,621



<b>POVERTY and SOCIAL</b>		<b>Bhutan</b>	<b>South Asia</b>	<b>Lower-middle-income</b>	
<b>2012</b>					
Population, mid-year (millions)		0.74	1,649	2,507	
GNI per capita (Atlas method, US\$)		2,420	1,437	1,893	
GNI (Atlas method, US\$ billions)		1.8	2,370	4,745	
<b>Average annual growth, 2006-12</b>					
Population (%)		1.8	1.4	1.5	
Labor force (%)		3.1	1.0	1.4	
<b>Most recent estimate (latest year available, 2006-12)</b>					
Poverty (% of population below national poverty line)		12	..	..	
Urban population (% of total population)		36	31	39	
Life expectancy at birth (years)		68	67	66	
Infant mortality (per 1,000 live births)		36	47	46	
Child malnutrition (% of children under 5)		13	32	24	
Access to an improved water source (% of population)		98	91	88	
Literacy (% of population age 15+)		..	62	71	
Gross primary enrollment (% of school-age population)		112	110	106	
Male		111	111	107	
Female		113	109	104	
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	<b>1992</b>	<b>2002</b>	<b>2011</b>	<b>2012</b>	
GDP (US\$ billions)	0.25	0.54	1.8	1.8	
Gross capital formation/GDP	45.6	59.9	56.1	..	
Exports of goods and services/GDP	32.0	24.9	34.6	..	
Gross domestic savings/GDP	21.7	40.2	38.0	..	
Gross national savings/GDP	..	31.4	..	..	
Current account balance/GDP	-9.8	-7.2	-2.0	-2.0	
Interest payments/GDP	0.7	0.4	2.0	3.3	
Total debt/GDP	35.6	71.9	57.2	82.0	
Total debt service/exports	6.9	4.6	..	..	
Present value of debt/GDP	..	..	..	68.3	
Present value of debt/exports	..	..	..	..	
	<b>1992-02</b>	<b>2002-12</b>	<b>2011</b>	<b>2012</b>	<b>2012-16</b>
<i>(average annual growth)</i>					
GDP	6.4	8.7	8.5	9.4	..
GDP per capita	4.9	6.5	6.7	7.6	..
Exports of goods and services	..	14.1	-0.9	..	..

<b>STRUCTURE of the ECONOMY</b>		<b>1992</b>	<b>2002</b>	<b>2011</b>	<b>2012</b>
<i>(% of GDP)</i>					
Agriculture		34.4	26.3	15.9	..
Industry		27.7	38.6	43.9	..
Manufacturing		9.0	7.7	9.3	..
Services		38.0	35.1	40.2	..
Household final consumption expenditure		59.6	39.2	41.2	..
General gov't final consumption expenditure		18.7	20.6	20.8	..
Imports of goods and services		55.9	44.6	52.7	..
	<b>1992-02</b>	<b>2002-12</b>	<b>2011</b>	<b>2012</b>	
<i>(average annual growth)</i>					
Agriculture		2.7	1.5	2.0	..
Industry		7.7	10.7	3.4	..
Manufacturing		8.5	11.7	12.0	..
Services		8.7	9.5	9.3	..
Household final consumption expenditure		..	14.1	6.3	..
General gov't final consumption expenditure		..	7.4	-2.1	..
Gross capital formation		..	1.0	10.9	..
Imports of goods and services		..	10.1	-2.5	..

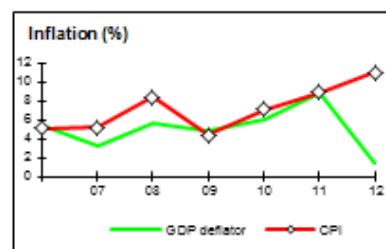


Note: This table was produced from the Development Economics LDB database.

\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

**PRICES and GOVERNMENT FINANCE**

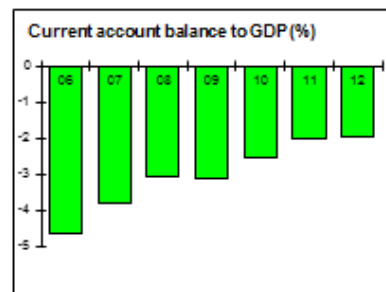
	1992	2002	2011	2012
<b>Domestic prices</b>				
<i>(% change)</i>				
Consumer prices	16.0	2.5	8.8	10.9
Implicit GDP deflator	9.3	4.9	8.8	1.5
<b>Government finance</b>				
<i>(% of GDP, includes current grants)</i>				
Current revenue	18.5	40.7	47.0	40.8
Current budget balance	0.8	-10.5	0.7	33.5
Overall surplus/deficit	-16.0	21.1	21.9	26.8

**TRADE**

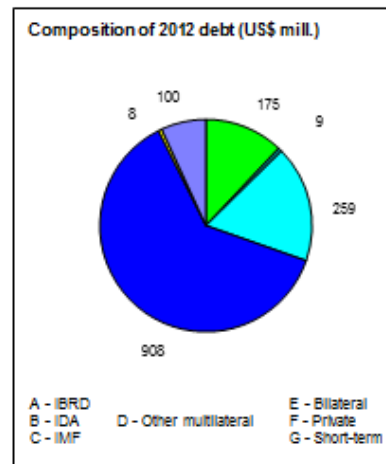
	1992	2002	2011	2012
<i>(US\$ millions)</i>				
Total exports (fob)	63	113	..	..
Agricultural products	..	..	..	..
Electricity	..	2,112	..	..
Manufactures	..	..	..	..
Total imports (cif)	83	206	..	..
Food	..	..	..	..
Fuel and energy	..	..	..	..
Capital goods	..	..	..	..
Export price index (2000=100)	..	..	..	..
Import price index (2000=100)	..	..	..	..
Terms of trade (2000=100)	..	..	..	..

**BALANCE of PAYMENTS**

	1992	2002	2011	2012
<i>(US\$ millions)</i>				
Exports of goods and services	86	133	..	..
Imports of goods and services	110	293	..	..
Resource balance	-25	-160	..	..
Net income	0	-11	-122	-123
Net current transfers	..	-39	..	..
Current account balance	-25	-39	-37	-35
Financing items (net)	51	-16	..	..
Changes in net reserves	-26	55	..	..
<b>Memo:</b>				
Reserves including gold (US\$ millions)	85	355	790	955
Conversion rate (LAC, local/US\$)	25.9	48.6	46.7	53.4

**EXTERNAL DEBT and RESOURCE FLOWS**

	1992	2002	2011	2012
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	89	386	1,048	1,459
IBRD	0	0	0	0
IDA	18	39	138	175
Total debt service	6	7	82	127
IBRD	0	0	0	0
IDA	0	0	3	3
Composition of net resource flows				
Official grants	32	32	77	78
Official creditors	9	93	215	342
Private creditors	-2	0	10	-2
Foreign direct investment (net inflows)	0	2	26	10
Portfolio equity (net inflows)	0	0	0	0
World Bank program				
Commitments	0	0	27	45
Disbursements	1	5	29	38
Principal repayments	0	0	2	2
Net flows	1	5	27	36
Interest payments	0	0	1	1
Net transfers	0	5	26	35



Note: This table was produced from the Development Economics LDB database.

3/15/14