



Report and Recommendation of the President to the Board of Directors

Project Number: 54183-001
April 2020

Proposed Countercyclical Support Facility Loan Kingdom of Bhutan: COVID-19 Active Response and Expenditure Support Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 23 April 2020)

Currency unit	–	ngultrum (Nu)
Nu1.00	=	\$0.0130915756
\$1.00	=	Nu76.385000

ABBREVIATIONS

ADB	–	Asian Development Bank
CARES	–	COVID-19 Active Response and Expenditure Support
COVID-19	–	coronavirus disease 2019
CPRO	–	COVID-19 Pandemic Response Option
CSF	–	Countercyclical Support Facility
ECP	–	economic contingency plan
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
NPL	–	nonperforming loan
SAARC	–	South Asian Association for Regional Cooperation
UNICEF	–	United Nations Children’s Fund
WHO	–	World Health Organization

NOTES

- (i) The fiscal year (FY) of the Government of Bhutan ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 30 June 2019.
- (ii) In this report, “\$” refers to United States dollars.

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 54183-001	
Project Name	COVID-19 Active Response and Expenditure Support Program	Department/Division	SARD/BHRM
Country	Bhutan	Executing Agency	Ministry of Finance
Borrower	Bhutan		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=54183-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=54183-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		5.00
	Public expenditure and fiscal management		10.00
	Social protection initiatives		5.00
		Total	20.00
3. Operational Priorities		Climate Change Information	
✓	Addressing remaining poverty and reducing inequalities	Climate Change impact on the Project	Low
✓	Accelerating progress in gender equality		
✓	Strengthening governance and institutional capacity		
✓	Fostering regional cooperation and integration		
Sustainable Development Goals		Gender Equity and Mainstreaming	
	SDG 1.a	Effective gender mainstreaming (EGM)	✓
	SDG 8.1, 8.3, 8.8		
	SDG 17.17		
4. Risk Categorization:		Poverty Targeting	
	Low	General Intervention on Poverty	✓
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		20.00	
Sovereign Countercyclical Support Facility Lending (Concessional Loan):		20.00	
Ordinary capital resources			
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		20.00	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Kingdom of Bhutan for the COVID-19 Active Response and Expenditure Support Program (CARES program) under the countercyclical support facility COVID-19 pandemic response option (CPRO).¹

2. The CARES Program will support the efforts of the Royal Government of Bhutan to stimulate the economy, protect public health, and mitigate the effects of the coronavirus disease 2019 (COVID-19) pandemic on the population. The government is implementing a comprehensive economic contingency plan (ECP) through an integrated social, fiscal, monetary, and programmatic approach to mitigate the shocks to the economy and protect public health. The program will support the economic response measures under the ECP.

3. The proposed program is critical, as it will provide timely support to help the government implement socioeconomic responses—supplementing the ongoing effective health responses to contain the pandemic. This reflects the ability of the Asian Development Bank (ADB) to respond quickly to the government’s needs, based on a strong record of ADB assistance to Bhutan in strengthening public sector and macroeconomic management. Bhutan meets all the access criteria of ADB’s CPRO under the countercyclical support facility (CSF). Table 1 summarizes the program’s compliance with the criteria. Detailed justification is in Appendix 4.

Table 1: Compliance with Access Criteria for CPRO

CPRO Access Criteria	ADB Staff Assessment
1. Adverse impact of exogenous shocks	Growth will likely plunge to 1.0%—a 5.0 percentage point drop from pre-COVID-19 estimates. Stringent preventive measures, though effective, have weakened the performance of the finance sector, the fiscal stance, and livelihoods.
2. Countercyclical development expenditures	Announced on 10 April 2020, the government’s pro-poor countercyclical economic contingency package worth about \$400 million (16.8% of GDP) is a comprehensive intervention. The bulk of this package (72.5%) involves cash transfers which will secure the livelihoods of 8.2% of the population living below the poverty line and at least 23,000 displaced employees and their families. This will be complemented by various financial measures encompassing interest waivers on loan deferment and subsidized loans for businesses. The combined expenditures are expected to keep demand afloat while mitigating insolvency.
3. Pre-shock record of generally sound macroeconomic management	Fiscal deficit has been maintained consistently lower than 3% of GDP since FY1993. Additional safeguards and prudential limits are reflected in the Public Debt Policy (2016). The Royal Monetary Authority also applies strong macro-financial prudence, with stringent reserve requirements and conservative capital adequacy ratios. Bhutan’s development philosophy of Gross National Happiness is inherently aligned with the Sustainable Development Goals.
4. Structural reforms	On 29 January 2020, the national contingency committee led by the Ministry of Health launched the National Preparedness and Response Plan (NPRP) for COVID-19 and established a technical group who implemented action plans for COVID-19 responses. The NPRP was activated when the first positive case was confirmed on 6 March 2020, followed by increased budget reallocation to implement high standard responses including mandatory government-funded quarantines and high rates of real-time reverse transcription polymerase chain reaction tests. The government has incurred about \$8.9 million, and an additional budget of \$26.6 million has been allocated to the Ministry of Health for worst-case scenario responses.
5. Debt sustainability	Although public debt reached 117.0% of GDP in FY2019, the IMF’s assessment reflected a “moderate level of debt distress” as 74.4% of this debt is concentrated in financially viable hydropower projects. In the long term, the situation is expected to improve as hydropower

¹ ADB. 2020. Policy Paper: [ADB’s Comprehensive Response to the COVID-19 Pandemic](#). Manila.

CPRO Access Criteria	ADB Staff Assessment
	debt peaks and nominal growth picks up. The proposed loan of \$20 million will result in a marginal 0.7% increase in the public debt stock.
6. Coordination with the IMF	ADB coordinates closely with the IMF on macroeconomic monitoring and participates in Article IV missions. The IMF supports ADB's response measures and provided the assessment letter.

ADB = Asian Development Bank, COVID-19 = coronavirus disease 2019, GDP = gross domestic product, IMF = International Monetary Fund.
Source: Asian Development Bank.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

4. **Coronavirus disease 2019 (COVID-19) spread in Bhutan.** The COVID-19 pandemic has spread rapidly around the world, including Bhutan. On 29 January 2020, the government launched the National Preparedness and Response Plan for COVID-19. On 30 January 2020, the World Health Organization (WHO) declared the COVID-19 epidemic a public health emergency of international concern. The Ministry of Health subsequently established a technical advisory group to prepare an action plan for the COVID-19 pandemic response. The group has completed implementing the health-focused COVID-19 contingency plans in the country's 20 districts and trained health staff and stakeholders on the various standard operating procedures related to COVID-19. The first case in Bhutan was confirmed on 6 March 2020, when a foreign tourist who arrived in the country by air on 3 March 2020 tested positive for COVID-19. The government subsequently undertook intensive surveillance of this patient's contacts. As of 23 April 2020, seven confirmed cases, all imported and three of whom have recovered, have been reported to WHO.²

5. **Free health services in Bhutan.** Bhutan's basic health services are free, as enshrined in the Constitution. Bhutan is in the medium category of the United Nations Human Development Index (0.62), ranked 134th out of 189 countries. It has seen rapid economic development, with an increase in gross domestic product (GDP) per capita from \$565 in 1990 to \$3,243 in 2018.³ Only 1.5% of the population lives under the \$1.9 a day international poverty line, while 8.2% are below the national poverty line.⁴ Comprehensive health services are provided through various levels of care, including treatment abroad if a service is not available in the country. Bhutan ranks second, after Sri Lanka, among the South Asian Association for Regional Cooperation (SAARC) countries on the universal health service coverage index, which comprises 16 indicators across four program areas: (i) reproductive, maternal, newborn, and child health; (ii) communicable diseases; (iii) noncommunicable diseases; and (iv) health service capacity, access, and health security.

6. **Inadequate health care system.** Despite these developments, the health sector faces challenges. Its bed–population ratio, at 1.8 hospital beds per 1,000 population, is much lower than 3.6 per 1,000 in Sri Lanka. Only one hospital in Bhutan (the Jigme Dorji Wangchuck National Referral Hospital in the capital, Thimphu) is equipped with CT scans and enough critical care beds to manage severe and critical COVID-19 cases. In addition, most hospitals and health facilities are in urban areas, and access to health care services is limited in most rural areas. Bhutan had only 3.7 doctors per 10,000 population and 14.1 nurses per 10,000 population as of 2017. Most doctors are primary care physicians, with specialists mostly based in Thimphu, where

² Royal Government of Bhutan, [Ministry of Health](#).

³ World Bank. [DataBank. Bhutan](#).

⁴ Government of Bhutan, National Statistics Bureau. 2017. [Bhutan Poverty Analysis Report 2017](#). Thimphu.

104 of the 269 doctors were located in 2016. COVID-19 is stretching Bhutan's health service delivery capacity, as it is already strained by the increasing burden of noncommunicable diseases, which account for 69% of all deaths (3,200 deaths per year, of which 1,700 are males and 1,500 are females).⁵

7. **Prevention and containment measures.** The government has taken early and stringent prevention and containment response measures. As a resource-constrained country with limited health facilities—infrastructure and personnel—an outbreak of infections could easily overwhelm the existing system capacity. Bhutan's extended family households also pose high potential contagion risks. When the first infectious case was identified, the government immediately pursued the highest standards of preventive and containment measures. These include prohibiting the arrival of foreign visitors to the country, restricting public gatherings, closing schools and educational institutions, and imposing mandatory quarantines financed by the government. The mandatory quarantine of 14 days for returning citizens and residents was extended to 21 days on 1 April 2020. As of 23 April 2020, 5,568 citizens who have returned from abroad are undergoing the mandatory quarantine period. Bhutan's 1,891 real-time reverse transcription polymerase chain reaction tests reflected the highest testing rate in the South Asian region, at 2,600 tests per million inhabitants. Out of those tested, 7 have been confirmed positive for COVID-19 and 98 are suspected cases. All visitors from high-risk countries are being tested for laboratory evidence of infection with COVID-19, irrespective of symptoms, effective 3 April 2020. The government has incurred about Nu672 million on preventive and preparatory activities such as quarantine facilities and the purchase of equipment and essential items. In the event of multiple local transmissions, a lockdown will be activated. Priorities will then shift to ensuring uninterrupted access to essential services and sustenance. To ensure this does not paralyze the country, while prioritizing public safety, targeted lockdowns will be implemented based on standard operating procedures consistent with WHO guidelines.

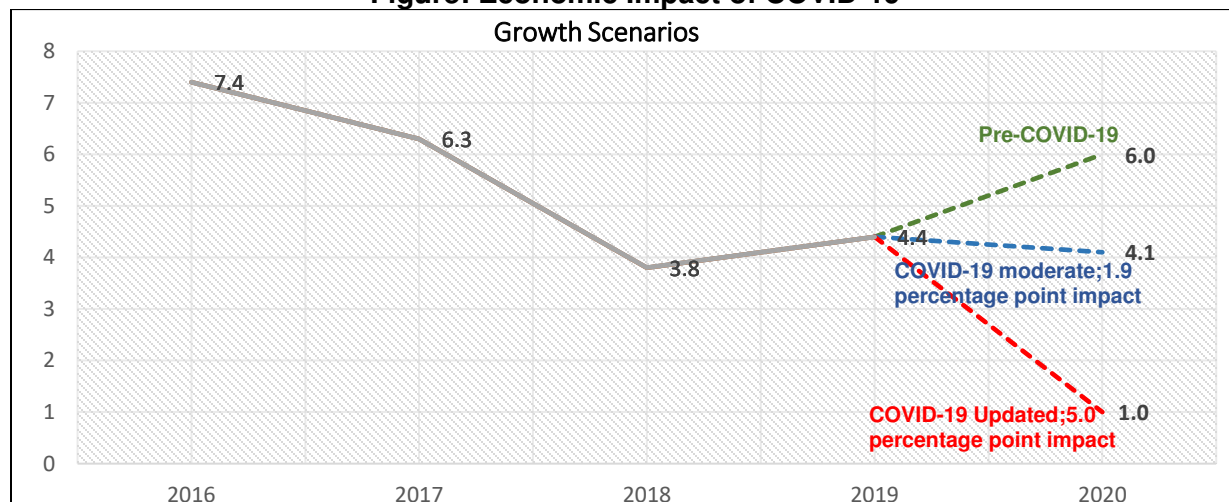
8. **Severe economic impacts.** The COVID-19 pandemic has significantly dampened growth prospects. The adverse socioeconomic impacts, including secondary effects, are complex. Since the first detection, stringent preventive measures to contain the spread of COVID-19 have resulted in an unprecedented decline in economic activity, including a complete standstill in industries such as tourism. The ban on entry of foreigners by air has had a significant negative impact on aviation and tourism and their supply chain of tour operators, hotels, restaurants, and transport. An initial 30% reduction in direct tourism receipts from the daily tariff for visitors is estimated for FY2020. Further restrictions were imposed on 23 March 2020, with the closure of surface entry points. This has resulted in significant supply-chain disruptions, especially on imports of goods and labor from India. The construction industry—traditionally a strong driver of growth—is now facing a shortage of 21,568 workers because of entry restrictions as the industry employs migrant labor, and manufacturing sector also faces disruptions in raw material supply. Other precautionary measures, such as social distancing, have also dampened retail sector demand.

9. **Uncertain economic outlook.** Developments suggest that the pandemic is likely to be protracted. This will severely test the capacity of economies, especially small landlocked developing countries, to absorb further shocks for a sustained period. Before the pandemic struck, GDP growth in FY2020 had been expected to rise to 6.0% because of increased hydropower capacity. However, ADB's lower-bound estimates for GDP growth, which is the likely current situation, factoring in the spillover effects caused by preventive restrictions and social distancing measures, could drive growth down by 5.0 percentage points to 1.0% in FY2020. This would

⁵ WHO. 2018. [Noncommunicable Diseases: Country Profiles 2018](#). Geneva.

translate to economic losses of about \$176 million, compared with pre-COVID-19 estimates—the lowest in 3 decades.⁶ The World Economic Outlook of the International Monetary Fund (IMF) also estimates Bhutan's growth at about 2.7% in FY2020, which is within the bounds estimated by ADB.⁷ The impacts are expected to be worse because actual data and forecasts do not capture the informal economy, which includes households and self-employed individuals who are not formally registered. Moreover, these estimates do not include the additional impacts emanating from supply disruptions, interrupted remittances, possible social and financial crisis, and long-term effects on health care and education.⁸ Therefore, the actual costs associated with containment measures are substantially higher.

Figure: Economic Impact of COVID-19



COVID-19 = coronavirus disease 2019.

Source: Asian Development Bank estimates.

10. **Fiscal pressure.** Efforts to contain the pandemic have placed significant fiscal pressure on the government. The directly affected sectors have multiple linkages to the rest of the economy—in addition to being employment-intensive, they contribute tax revenue and convertible currency. The immediate fiscal impacts in FY2020 resulting from foregone revenues from tourism royalties, visa fees, and income taxes are estimated to be Nu887 million.⁹ Further, fiscal space will shrink as a result of diminished demand, causing losses in sales taxes and corporate income taxes. Initial estimates for FY2020 alone highlight a 9.0% decline in domestic revenue compared with initial projections (Table 2). Consequently, the fiscal deficit is expected to widen to 5.6% of GDP compared with a pre-COVID-19 estimate of 3.0% of GDP for FY2020. The impacts for FY2021 are projected to be more pronounced, with a steep decline in domestic revenue by 21.0% contributing to further widening of the fiscal deficit to 9.4% of GDP. Considering that government spending accounts for 27.4% of GDP, an inevitable weakening of the government's fiscal position will reinforce weak aggregate demand in the absence of offsetting sources of funding.

11. The pandemic has also forced a reprioritization of the government's development activities. Considering that growth was expected to receive impetus from a 51.0% elevation in

⁶ ADB estimates, 9 April 2020.

⁷ International Monetary Fund. April 2020. *World Economic Outlook*. Washington, DC.

⁸ While the share of net remittances on growth is negligible, with some years in negative territory because of the large number of migrant laborers working in hydropower and construction, remittance figures have been steadily increasing in recent years, from \$0.4 million in 2018 to \$10.0 million in 2019. Bhutan can expect to see a decline in remittances in 2020 because of COVID-19.

⁹ Royal Government of Bhutan, Ministry of Finance estimates, March 2020.

capital expenditure, the supply disruptions will severely impede infrastructure expansion and other development spending, thereby depressing longer-term growth prospects.¹⁰

Table 2: Provisional Fiscal Position Following COVID-19^a

Indicator	FY2020		FY2021	
	Approved Budget	Revised Budget (March 2020)	Projection (Budget)	Revised Budget (March 2020)
A. Domestic revenue	43,299.07	39,462.16	43,053.48	33,849.25
1. Tax	26,776.85	26,155.82	30,553.39	22,323.94
2. Non-Tax	16,522.22	13,306.33	12,500.09	11,525.31
B. Total expenditure	61,197.31	64,614.71	69,714.64	67,752.74
1. Current	34,652.77	35,806.84	41,845.67	39,896.68
2. Capital	26,544.54	28,807.87	27,868.98	27,856.06
C. Fiscal balance	(6,578.11)	(10,923.18)	(12,247.17)	(19,625.68)
1. Fiscal deficit as % of GDP	(3.0)	(5.6)	(5.1)	(9.4)

() = negative, COVID-19 = coronavirus disease 2019.

^a These are provisional estimates that have not been officially endorsed and are subject to revision. Fiscal Balance (C) = Total Resources [Domestic Revenue (A) + Grants] - Total Expenditure (B) + Onlending. The table omits two items—grants and onlending—to clearly demonstrate the impact of COVID-19 on domestic resources and expenditure and, consequently, on fiscal deficit.

Sources: Provisional estimates by the Government of Bhutan, Department of Macroeconomic Affairs and the Asian Development Bank.

12. Significant risks to the finance sector. The preventive measures pose significant risks to the finance sector. The economic slowdown will affect the asset quality of both the banking and nonbanking financial segments. Tourism and services account for 23.0% of outstanding credit, retail trade for 14.0%, and construction for 27.0%, all of which will be under stress. Nonperforming loans (NPLs) increased sharply from 12.8% to 29.8% in tourism and from 17.4% to 32.5% in transport from December 2019 to March 2020. With accelerating job losses and plummeting demand reinforcing each other, borrower defaults are imminent. The sharp increase in NPLs, as small and medium-sized enterprises struggle to meet debt repayments, signal weakening bank balance sheets and a further breach in macro-prudential thresholds.¹¹ This is evident in the increase in NPLs for trade and commerce from 17.2% to 27.0% over the same period. The nonbank financial industry is similarly challenged, with falling credit growth and rising NPLs. Nonbank NPLs increased in all areas from December 2019 to March 2020—from 24.1% to 38.2% in the service sector, from 19.1% to 51.8% for personal loans, from 25.5% to 46.8% for trade and commerce, and from 21.0% to 45.4% in transport. The general insurance segment has been severely affected by the slowdown in areas such as construction, vehicles, and equipment imports. This is aggravated by the inevitable increase in defaults on life insurance premiums because of job losses. Capital markets, which have witnessed some growth in secondary trading over the past few years, are expected to slow down significantly, wiping out recent gains. With an anticipated fall in dividend payouts in the corporate segment, stock prices are anticipated to fall combined with lower demand for new capital and a decline in fund-raising.

13. Profound social impacts. COVID-19 will also have profound social impacts. An estimated 11,798 employees in the tourism and allied industries will be directly affected. Hotels and restaurants have a disproportionately large share of unskilled female employees. The informal sector, which includes households and self-employed individuals, also engages a large number (estimated at 80% of the workforce) of unskilled and vulnerable groups such as young

¹⁰ ADB. 2020. *Asian Development Outlook 2020: What Drives Innovation in Asia?* Manila.

¹¹ Royal Monetary Authority of Bhutan. 2020. *Monthly Statistical Bulletin*. XIX (3). Thimphu.

school dropouts and migrants from rural areas.¹² With an official youth unemployment rate of 15.7% in 2018 (female youth unemployment of 16.1%), a surge in joblessness is inevitable.¹³ When impacts on other industries (including manufacturing, trade, and construction) are considered, ADB estimates that about 23,000 jobs are at risk (footnote 6). Likewise, the poverty headcount rate based on \$1.9/day (adjusted for purchasing power parity) is expected to result in 2,176–12,362 additional poor, driven by a COVID-19-induced per capita reduction in consumption of 5%–20%.¹⁴

14. Sound macroeconomic management. The government maintained a sound macroeconomic management record before the pandemic. From FY1998 to FY2018, Bhutan's economy grew remarkably—at an annual average of 7.0%—driven by hydropower construction and operations. Before the pandemic, the economy showed relatively strong performance, with positive longer-term development prospects (Table 3). While public debt and the current account deficits are high, this largely reflects borrowing for investment in the expansion of revenue-generating hydropower capacity. The government has demonstrated its commitment and ability in servicing its debt without reneging on any repayments. Its Public Debt Policy (2016) also provides clear guidelines for public institutions in accessing debt, with numerous safeguards. The constitution requires that all recurrent expenditure be financed by domestic resources, which ensures that any debt availed is channeled toward capital investment. The Constitution mandates a minimum reserve requirement of 12 months of essential imports. Further, the government's macroeconomic prudence has ensured adequate buffers to address any possible balance-of-payments challenges. On the external front, this is most evident in the cautious management of convertible currency reserves and stringent external commercial borrowing regulations, resulting in a healthy accumulation of international reserves. This enabled the government to address balance-of-payments challenges in 2013 when the Royal Monetary Authority (the central bank) liquidated \$400 million to finance the current account deficit with India, without breaching the constitutional threshold. On the domestic financial front, macro-financial prudence exercised over the years has strengthened fundamentals, enabling the economy to build capital adequacy buffers to absorb macroeconomic pressures.

Table 3: Pre-COVID-19 Macroeconomic Indicators

Item	Fiscal Year				
	2015	2016	2017	2018	2019
GDP growth (% , constant prices)	6.2	7.4	6.3	3.8	4.4
Inflation (CPI % change)	6.7	3.4	4.3	3.6	2.8
Current account balance (% of GDP)	(28.3)	(31.1)	(23.2)	(19.1)	(22.6)
Revenue and grants (% of GDP)	28.8	29.9	27.2	31.9	24.5
Current revenue		20.5	19.5	22.6	19.6
Expenditure and on lending	29.3	32.0	31.9	32.2	27.4
Overall fiscal surplus (deficit)	(1.5)	(1.1)	(3.4)	(0.3)	(2.2)
Public debt (% of GDP)	94.0	112.3	109.3	105.2	117.0
Gross international reserves (\$ million)	958	1,119	1,104	1,111	1,065

() = negative, COVID-19 = coronavirus disease 2019, CPI = consumer price index, GDP = gross domestic product. Sources: Asian Development Bank estimates and Government of Bhutan, National Statistics Bureau.

15. Based on pre-COVID-19 estimates, Bhutan's economy was expected to rebound in FY2020 from two consecutive years of lackluster growth—3.8% in FY2018 and 4.4% in FY2019. Sluggish growth reflected a substantial decline in construction as government investment and hydropower production, a major industry driver, suffered a marked decline. During this period, growth in services once again picked up the slack, underpinned by broad expansion in tourism,

¹² World Bank. 2016. *Bhutan's Labor Market: Toward Gainful Quality Employment for All*. Washington, DC.

¹³ Royal Government of Bhutan, National Statistics Bureau. 2018. *2018 Labour Force Survey Report, Bhutan*. Thimphu.

¹⁴ ADB estimates. National estimates that do not adjust for purchasing power place the headcount ratio at 8.2%.

wholesale and retail trade, transportation and storage, and hotels and restaurants. Inflation was also at a 10-year low, at 2.8% in FY2019. An anticipated rebound of 6.0% for FY2020 was predicated based on fiscal expansion as well as robust consumption growth.¹⁵

16. **Government's socioeconomic responses.** While the government has implemented the National Preparedness and Response Plan for COVID-19 effectively, the plan's stringent measures on border closure and isolation have caused adverse socioeconomic impacts (paras 8–13). To mitigate the adverse impacts, the government launched the Nu30 billion (about \$400 million) ECP, equivalent to about 16.8% of GDP, on 10 April 2020. The proceeds of ECP will be channeled through the newly established National Resilience Fund. The government priority is to ensure that the livelihoods of the marginalized are secured, and the impacts on productive sectors are mitigated so they can eventually rebound. Given the data and information constraints and the largely informal nature of employment, the risks of exclusion of vulnerable people are high, prompting a blanket extension of relief for some interventions. Hence, the financing requirements relative to GDP are large. To ensure an inclusive intervention reaches as many of the affected people as possible, the government plans to execute the ECP through three broad approaches below, which complement each other, making the program more impactful.

- (i) **Social relief.** This takes the form of direct monthly cash transfers to affected individuals, for an initial period of 3 months, extendable to 12 months depending on the situation. This will involve an outlay of Nu21,665 million (about 72.5% of the total ECP cost), which will directly benefit 8.2% (about 57,000 people) of the population living below the poverty line (footnote 4) plus at least an estimated 23,000 displaced employees, unemployed people actively seeking jobs, and self-employed individuals in the informal sector (footnote 6). Monthly disbursements up to Nu12,000 per person will be made directly to the bank accounts of beneficiaries, if available. At the central level, the Ministry of Labour and Human Resources will coordinate the registration and verification of beneficiaries. At the local level, decentralized institutional bodies, including social welfare officers, will be leveraged to verify and facilitate the disbursement of benefits to those who do not have bank accounts.
- (ii) **Monetary and fiscal measures.** The total outlay for these measures is about Nu4.6 billion (about 15.0% of the total ECP cost). Monetary measures are critical to ensure the economy has adequate money for business entities to function. These include (a) a waiver of interest and a 3-month loan repayment deferment for all businesses and individuals; (b) subsidized working capital at a preferential rate of 5 %; (c) a 3-month extension of the gestation period for ongoing projects (extendable by another 3 months); (d) working capital through the Cottage and Small Industries Bank for cottage and small industries at an interest rate of 4% for a 3-month period (extendable by another 3 months); and (e) micro-loans through Cottage and Small Industries Bank up to a ceiling of Nu0.5 million at an interest rate of 2% for a 3-month period (extendable by another 3 months).¹⁶ The government will also execute fiscal measures to ease cash flow constraints on businesses. These include deferments of business and corporate income taxes and the sales tax for businesses and customs duty on essential imports. As an immediate measure, budgetary funds have been disbursed to procure 6 months'

¹⁵ ADB estimates (2020). This is the baseline forecast. The growth rate of 5.2% highlighted in the *Asian Development Outlook 2020* factors in some minor impacts (ADB. 2020. [Asian Development Outlook 2020: What Drives Innovation in Asia?](#) Manila).

¹⁶ Bhutan's lending rates in FY2019 ranged from 7.94% to 14.0%, averaging 10.97%.

worth of essential commodities reserves, totaling Nu1.23 billion. As a highly import-dependent country, these reserves are a critical component of the National Preparedness and Response Plan for COVID-19. In the event of a complete lockdown in Bhutan coupled with the extended lockdown period in India, the country will likely experience acute shortages in essential food and commodities. The ECP fiscal measures also include initial budget allocation of Nu1.0 billion to the Ministry of Health for the prevention, containment, and treatment of COVID-19 from April 2020 to August 2020, and additional budget allocation of Nu2.0 billion for health-related responses in preparation for a worst-case scenario.

- (iii) **Targeted interventions.** In addition to conventional fiscal measures, the government is planning to execute targeted projects to engage the displaced in productive activities. This is contingent on no detection of local transmission of COVID-19, which would result in a complete lockdown. These targeted interventions will focus on absorbing the economically displaced in three sectors: (a) tourism through tourism infrastructure development and upskilling, (b) agriculture through food security, and (c) construction. The proposed outlay for these interventions is Nu3.7 billion (about 12.5% of the total ECP cost).

17. **Regional cooperation and integration.** Given the constraints arising from being a small landlocked economy, regional cooperation is critical on many fronts. Foremost, the economy is heavily integrated with neighboring India through fiscal and trade channels, most notably in mutually beneficial energy cooperation. It is also continuously pursuing integration with other members of SAARC. This is most evident in the increase in Bhutan–Bangladesh trade facilitation arrangements. As a heavily import-dependent country, for both goods and labor, the pandemic has imposed significant disruptions. Nevertheless, the government has entered into an arrangement with the Government of India to ensure an uninterrupted supply of essential commodities and raw materials. At the regional level, the government has expressed its solidarity by contributing \$100,000 to the SAARC COVID-19 Emergency Fund to combat the pandemic. In addition to contributions from SAARC member states, the SAARC Development Fund contributed \$5 million to the emergency fund. Furthermore, the South Asia Subregional Economic Cooperation program recognizes the importance of regional cooperation in ensuring coordinated responses to mitigate the impact of the pandemic effectively—most importantly in the recovery process.

B. Proposed Program and ADB's Value Addition

18. **Proposed program.** The CARES Program will support the government in implementing its countercyclical comprehensive COVID-19 response. It will support the implementation of relief measures for vulnerable groups and economic stimulus measures for productive sectors. It will provide the government with the fiscal space to address critical public health needs while managing the economic downturn. The program is aligned with the following ADB Strategy 2030 operational priorities: (i) addressing remaining poverty and reducing inequalities, (ii) accelerating progress in gender equality, (iii) strengthening governance and institutional capacity, and (iv) fostering regional cooperation and integration.¹⁷ ADB's long-standing experience in Bhutan in the areas of public sector management, health and gender; including engagement with other development partners, will add value to the proposed program.

¹⁷ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

19. **ADB's Value Addition.** ADB has long-standing experience in Bhutan highlights value addition in areas of (i) public sector management, (ii) health care capacity and gender inclusiveness, and (iii) development partner coordination. ADB's sustained engagement in key sectors, accompanied by flexibility in approaches and modalities and a quick response to country needs, is important for development effectiveness.¹⁸ ADB's support on public sector management has encompassed (i) improving macroeconomic stability and resilience to shocks; (ii) strengthening debt and government financial management; (iii) enhancing the stability and integrity of the financial systems and regulatory reforms; (iv) supporting capital market development; and (vi) supporting capacity building. ADB supported the government in addressing macroeconomic shocks and structural issues resulting from the Indian rupee shortage in 2012–2013, through both policy advice and two policy-based loans on strengthening macroeconomic management.¹⁹ Aligned with the first strategic pillar of the country partnership strategy, 2019–2023, integrated reform programs and technical assistance are programmed to provide continuing support on public sector and finance sector management, aiming to help Bhutan's sustainable recovery. Two structural reform programs for rural finance development and finance sector development are programmed in 2020–2021.²⁰

20. ADB has provided health-related and gender mainstreaming support. In response to the COVID-19 outbreak, in March 2020 it has approved a grant of \$100,000 to support Bhutan in enhancing its capacity to prevent, detect, and respond to the COVID-19 outbreak.²¹ ADB is also expediting medical supply procurement packages worth \$400,000 that can be used for COVID-19 treatment under the ongoing Health Sector Development Program.²² The CARES gender-related support builds on ADB's prior technical assistance to strengthen gender mainstreaming at the central and decentralized levels. The government's response to COVID-19 has an explicit focus on the needs and constraints faced by women and is informed by the findings of the ADB-supported study on unpaid care work, which points to women's greater exposure and vulnerability to external shocks because of their multiple responsibilities as breadwinners and caretakers of children, the elderly, and the sick.²³

21. ADB has collaborated closely with the IMF and other development partners. ADB is coordinating with the World Bank in its COVID-19 response assistance, which consists of about \$19.8 million through its Investment Project Financing and International Bank for Reconstruction and Development Catastrophe Deferred Drawdown Option, scheduled for approval by June 2020. In addition, the World Bank is providing the third programmatic Development Policy Credit for strengthening fiscal management and private sector employment opportunities in the amount of \$40 million. Likewise, the IMF continues to provide advisory and technical support to the government in public sector and financial management, as well as regular debt sustainability analysis in conjunction with its Article IV consultation missions, in which ADB participates as a mission member. For public health response, ADB has worked closely with WHO (lead), the United Nations Children's Fund (UNICEF), and other resident United Nations agencies and development partners. ADB has participated in development partner group meetings and worked

¹⁸ Independent Evaluation Department. 2019. [Validation of the Country Partnership Strategy Final Review, 2014–2018 in Bhutan](#). Manila: ADB.

¹⁹ ADB. 2013. [Strengthening Economic Management Program](#). Manila; ADB. 2015. [Strengthening Economic Management Program II](#). Manila.

²⁰ ADB. 2019. [Country Partnership Strategy: Bhutan, 2019–2023—Fostering Diversification and Reducing Disparities](#). Manila; ADB. 2019. [Country Operations Business Plan: Bhutan, 2020–2022](#). Manila.

²¹ ADB. 2020. [Technical Assistance for Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases](#). Manila.

²² ADB. 2018. [Health Sector Development Program](#). Manila.

²³ Royal Government of Bhutan, National Commission for Women and Children. 2019. [Accounting for Unpaid Care Work in Bhutan 2019](#). Thimphu.

closely with the Ministry of Health, Ministry of Finance (MOF), and Ministry of Foreign Affairs to coordinate support measures. Details on development partners supporting Bhutan in public sector management, health sector, and the COVID-19 response are in Development Coordination document.²⁴

C. Impacts of the Reform

22. The program will contribute to government expenditures for mitigating the immediate adverse effects of COVID-19 on businesses and the population. This will be achieved through two reform areas: (i) inclusive relief measures for vulnerable groups—displaced employees, unemployed people actively seeking employment, and self-employed individuals in the informal sector, most of whom are women—implemented; and (ii) economic stimulus for productive sectors provided. The first reform area will secure at least 6 months' worth of commodities reserves to ensure uninterrupted supply for the entire population, which is crucial for a highly import-dependent country in the event of a complete lockdown. Efficient distribution channels will be used to reach the most vulnerable, including women and the economically displaced. The second reform area will implement measures to provide economic relief to productive sectors, stimulating some level of demand and economic activity. This will involve (i) 3-month deferment of loan repayments at 0% interest for all businesses and individuals, and (ii) highly subsidized loans at 2% interest for rural and agricultural activities, both with gender targets to address the impact of the COVID-19 outbreak on vulnerable women. The design and monitoring framework is in Appendix 1.

D. Development Financing Needs and Budget Support

23. Provisional estimated requirements for the relief efforts, to be disbursed from FY2020–2021, total Nu30 billion (equivalent to \$392.75 million or about \$400 million).²⁵ Table 4 presents a breakdown of the sources of financing. At present, the financing gap is expected to be largely mobilized domestically. Besides budgetary re-appropriation and savings from the Stabilization Fund, the government will issue treasury bills and borrow from domestic financial institutions. Additional domestic financing is possible because of capital buffers accumulated through years of macro-financial prudence (para. 14).

Table 4: Breakdown of Financing Sources

Sources	Amount		Share (%)
	(Nu million)	(\$ million)	
A. Government funds	4,310.00	56.42	14.36
B. Private and corporate contributions	1,554.00	20.34	5.18
C. External grants ^a	5,000.00	65.46	16.67
D. Domestic borrowing	13,040.48	170.72	43.47
E. External borrowing ^b	6,095.52	79.80	20.32
Of which: World Bank ^c	4,567.82	59.80	
ADB CARES Program	1,527.70	20.00	
Total	30,000.00	392.75	100.00

ADB = Asian Development Bank, CARES = COVID-19 Active Response and Expenditure Support

^a Bilateral assistance from Government of India and other bilateral agencies and United Nations agencies.

^b Currently under consideration for approval by June 2020. This will be increased considering additional borrowing under ADB's and World Bank's pipeline 2020–2021 programs.

^c Concessional loans being processed for disbursement by June 2020, including (i) Investment Project Financing (\$5.0 million), (ii) Catastrophe Deferred Drawdown Option (\$14.8 million), and (iii) Third Development Policy Credit (\$40.0 million).

Sources: Royal Government of Bhutan, Ministry of Finance; and Asian Development Bank estimates.

²⁴ Development Coordination (accessible from the list of linked documents in Appendix 2).

²⁵ Royal Government of Bhutan, Prime Minister's Office. 2020. *Economic Contingency Plan*. Thimphu.

24. The government has requested a concessional loan of \$20 million from ADB's concessional ordinary capital resources to help finance the program. The program will be funded by a portion of the country's performance-based allocation in concessional ordinary capital resources lending. The loan will have a 24-year term, including a grace period of 8 years; an interest rate of 1.0% per year during the grace period and 1.5% per year thereafter; and such other terms and conditions set forth in the draft loan agreement.²⁶

25. **Debt sustainability.** Bhutan's public and publicly guaranteed debt (public debt) reached 117.0% of GDP in FY2019, of which domestic debt is 8.9% of GDP in FY2019.²⁷ Of the total external debt, about 74.4% is Indian rupee-denominated self-liquidating hydropower debt, and the remaining 25.6% in convertible currencies is mostly on concessional terms from multilateral development banks. Hydropower project loans from the government of India are low risk, in which India covers both the financial and construction risks of the projects and buys surplus electricity at a price, reflecting cost plus a 15.0% net return. Despite exceeding conventional thresholds, the economic and financial viability of these loans are corroborated by the IMF's assessment of a "moderate level of debt distress."²⁸ In addition, Bhutan's non-hydropower external debt stock is well within the thresholds stipulated in the Public Debt Policy (35% of GDP).²⁹ In the medium term, Bhutan's public debt, after falling to 116.4% of GDP in FY2020, will increase to 119.1% in FY2021 as nominal GDP growth falls and the primary deficit rises because of the pandemic. The debt-to-GDP ratio is likely to continue to fall as the economic conditions improve and the primary balance turns a surplus and reaches 79.5% in FY2024. The proposed loan of \$20 million will result in a marginal 0.7% increase in the public debt stock. ADB's and the World Bank's loans for FY2020 budget support are concessional, which will not alter the rating under the IMF-World Bank debt sustainability analysis. Details are in the Debt Sustainability Analysis document (footnote 26).

E. Implementation Arrangements

26. The program will be implemented from May 2020 to June 2021. The MOF will be the executing agency for the CARES Program. The government, through the MOF, will monitor the budget execution and flow of funds for countercyclical measures under the ECP. The MOF will submit reports on expenditures made from the national budget to support the countercyclical measures under the ECP to ADB. The government has set up a dedicated committee within the MOF to monitor the implementation of the National Resilience Fund. The Prime Minister's Office and a special task force led by the governor of the central bank will oversee the implementation and coordination of the ECP, facilitated by a weekly review meeting. For monitoring and evaluation, tracking of program beneficiaries will be undertaken by relevant agencies such as the Ministry of Labour and Human Resources, the Tourism Council of Bhutan, and the National Statistics Bureau through a central management information system. To ensure effective targeting and monitoring, the government has started registration of vulnerable groups, including single mothers, elderly, differently abled, displaced employees, and those in informal sector. Gender targets have also been set in the design and monitoring framework and will be tracked during program implementation and adequately reported in MOF's semiannual progress reports.

²⁶ Loan Agreement (accessible from the list of linked documents in Appendix 2).

²⁷ Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2) was conducted by ADB in April 2020. The actual government debt-GDP figures in FY2019 were 109.7%, as reflected in the *Asian Development Outlook 2020* (ADB, 2020, [Asian Development Outlook 2020: What Drives Innovation in Asia?](#) Manila), but the variation in the Debt Sustainability Analysis is due to the use of estimated debt figures from the IMF's WEO 2019 to ensure consistency for the following years (FY2020-FY2024).

²⁸ International Monetary Fund (IMF). 2018. Bhutan: 2018 Article IV Consultation. *IMF Country Report*. No. 18/300. Washington, DC.

²⁹ Royal Government of Bhutan, Ministry of Finance. 2016. [Public Debt Policy 2016](#). Thimphu.

Resources from an ADB TA on Strengthening Policy Formulation and Implementation (programmed for 2020 approval) will support MOF to ensure timely and effective monitoring and reporting of the program's social and gender-related targets and gender-related impacts. The proceeds of the loan will be withdrawn in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

27. **Safeguards.** The program is not expected to have adverse environmental or social safeguards impacts and will not trigger ADB's safeguards policy requirements. It is *category C* for environment, involuntary resettlement, and indigenous peoples. Investment activities prohibited under ADB's Safeguards Policy Statement (2009) will be excluded.

28. **Poverty and social.** Bhutan has made remarkable progress in poverty reduction through broad-based and targeted poverty interventions. Both consumption-based poverty measures and multidimensional poverty indicators show that the percentage of income poverty reduced substantially from 23.0% in 2007 to 8.2% in 2017; and multidimensional poverty from 12.7% to 5.8% in the same period (footnote 4). However, inequality remains. The Gini coefficient, a measure of inequality, increased to 0.38 in 2017 from 0.36 in 2012. The disparity between urban and rural areas is marked—highest in the rural district of Dagana compared to lowest in Paro, near the capital. With an already high unemployment rate among the youth (15.7% in 2018), the COVID-19 pandemic may increase the numbers by an estimated 11,798 employees directly affected in the tourism and allied industries. Given that most people participating in the informal economy are women and single-ownership self-employed individuals, the impact on them is likely to be worse.³⁰ The government's ECP commits to deliver timely and effective livelihood support to the most vulnerable segments of the population.

29. **Gender.** The program is categorized *effective gender mainstreaming*. Bhutan has high levels of gender inequality and ranks 134th out of 142 countries on the Gender Inequality Index. Gender inequality is high in the areas of literacy, employment, and access to finance. The literacy rate for male adults is 78.1% compared with only 63.9% for female adults.³¹ Female unemployment remained higher than male unemployment for more than a decade, and women have lower participation in regularly paid employment (18.4% compared with 33.4% for men). Women still account for higher employment (63.2% against 46.4% for men) in agriculture and farming enterprises,³² a sector with the least productivity and a meager share of 5.0% of the total credit in the country. As of December 2017, out of the 16.1% of the population who had access to credit, 36% were women and 54% were men.³³ Given women's greater exposure and vulnerability to the impact of the pandemic, ADB's program will support key government expenditure items with significant gender equality and social inclusion elements. These include (i) the establishment of a National Resilience Fund with a gender, age, and disability targeting and monitoring system and (ii) loan deferment schemes and micro loans addressing the needs of businesses headed by women. Gender targets have been set in the design and monitoring framework and will be monitored, tracked, and reported during program implementation. Targeting, monitoring and evaluation system for vulnerable groups, is described in para. 26.

³⁰ Royal Government of Bhutan, National Statistics Bureau. 2019. [Economic Census of Bhutan, 2018–2019](#). Thimphu.

³¹ Royal Government of Bhutan, National Statistics Bureau. 2018. [Population and Housing Census of Bhutan, 2017](#). Thimphu.

³² Royal Government of Bhutan, National Statistics Bureau. 2018. [Labour Force Survey Report: Bhutan, 2018](#). Thimphu.

³³ Royal Monetary Authority of Bhutan. 2017. [National Financial Inclusion Strategy, 2018–2023](#). Thimphu.

30. **Governance.** Bhutan's inherent financial management risk is considered *moderate*. The 2016 Public Expenditure and Financial Accountability assessment reported notable improvements and reforms from the previous assessment in 2010.³⁴ In response to lower scores on accounting and reporting, government transparency, and budget reliability; the government is implementing a public financial management reform action plan to tackle the deficiencies. Further, the government enhanced public expenditure management through the adoption of electronic public expenditure management, which allowed for real-time transactions. Bhutan consistently scores high on global indexes for the control of corruption and ranked 25th out of 180 countries in Transparency International's 2019 Corruption Perception Index. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

31. **Risks and mitigating measures.** Major risks and mitigating measures are summarized in Table 5 and described in detail in the risk assessment and risk management plan.³⁵

Table 5: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Prolonged COVID-19 pandemic and containment render the economic stimulus less effective, leading to continued economic slowdown, disruption of business operations and supply chains, and further loss of income and employment.	ADB engages continually with the government and other development partners to devise an effective and appropriate response, including additional support if required. The comprehensive monetary measures by the RMA (central bank) will support businesses in easing cash flow issues through loan deferment with 0% interest rate, combined with highly concessional loans to the productive sectors, will stimulate businesses and the economy. The proposed CARES Program will support these measures.

ADB = Asian Development Bank, COVID-19 = coronavirus disease 2019, RMA = Royal Monetary Authority.
Source: Asian Development Bank.

IV. ASSURANCES

32. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement.

V. RECOMMENDATION

33. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$20,000,000 to the Kingdom of Bhutan for the COVID-19 Active Response and Expenditure Support Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% per year thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President

24 April 2020

³⁴ World Bank. 2016. [Bhutan Public Financial Management Performance Report: Based on Public Expenditure and Financial Accountability 2016 Framework](#). Washington, DC.

³⁵ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objectives Adverse impacts of COVID-19 on the economy, and well-being of the population, mitigated (Economic Contingency Plan and the National Preparedness and Response Plan for Outbreak of COVID-19) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Program^b Immediate adverse effects of COVID-19 on businesses and the population mitigated	By December 2021 a. At least 80,000 vulnerable groups received support from the National Resilience Fund (April 2020 baseline: 0) ^c b. At least 20 essential supply outlets maintained operational with minimum interruption (April 2020 baseline: 0) c. At least 70% of cottage and small industries (CSIs) that received economic stimulus support still in business (April 2020 baseline: 0)	a.–c. MOF budget and revenue reports	Prolonged COVID-19 pandemic and containment render the economic stimulus less effective, leading to continued economic slowdown, disruption of business operations and supply chains, and further loss of income and employment.
Reform Areas^d 1. Inclusive relief measures for the vulnerable groups ^e implemented	By June 2021 1a. National Resilience Fund established, with gender, age, and disability targeting and monitoring system (April 2020 baseline: not applicable) 1b. About \$16 million worth of essential commodities reserves for 6 months secured and distributed for entire population (April 2020 baseline: not applicable)	1a. Resilience Fund document published on MOF website 1b. MOF budget report	
2. Economic stimulus for productive sectors provided	By June 2021 2a. Loans of at least 110,000 business establishments and individual debtors (including at least 35% women or women-headed business establishments) deferred for 3 months (until June 2020) at 0% interest rate (April 2020 baseline: 0) 2b. Microloans up to Nu0.5 million at highly concessional rate of 2% provided to at least 5,000 individuals or cottage and small industries in rural areas (including at least 30% women or women-	2a. MOF national budget report and national revenue report 2b. Annual Report, Bhutan Development Bank Limited	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	headed cottage and small industries) (April 2020 baseline: 0)		
Budget Support ADB: \$20,000,000 (concessional ordinary capital resources loan)			

ADB = Asian Development Bank, COVID-19 = coronavirus disease 2019, MOF = Ministry of Finance.

^a Government of Bhutan, Prime Minister's Office. 2020; Government of Bhutan, Ministry of Health. 2020. [National Preparedness and Response Plan for Outbreak of Novel Coronavirus COVID-19](#). Thimphu.

^b It is not possible to set more specific and realistic effects of the program targets than those presented in the design and monitoring framework because of uncertainties regarding how the outbreak will unfold, its economic effects, the need for government responses to be flexible as the situation evolves, and since new data collection and reporting systems to monitor the crisis are being developed and evolving. Additional indicators to measure the effects will be identified later and used to report on the program's effectiveness as comprehensively as possible in the project completion report.

^c Vulnerable groups include displaced employees, people who are unemployed and actively seeking employment, and self-employed individuals in the informal sector, most of whom are women. They also include the 8.2% of the population below poverty line—about 57,000 as per the National Poverty Analysis 2017, and 23,000 people who are at the risk of losing their jobs as per ERCD, ADB estimates (2020).

^d Given the data and information constraints and the largely informal nature of employment, the risks of exclusion of vulnerable people are high, prompting a blanket extension of relief for some interventions.

Contribution to ADB Results Framework: To be determined.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=54183-001-3>

1. Loan Agreement
2. Development Coordination
3. Country Economic Indicators
4. International Monetary Fund Assessment Letter
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. List of Ineligible Items
8. Debt Sustainability Analysis

Supplementary Document

9. Sector Assessment (Summary): Public Sector Management

DEVELOPMENT POLICY LETTER



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ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG

Development Policy Letter

Finance Minister

DMEA/ADB/2020/

April 17, 2020

Mr. Masatsugu Asakawa
President,
Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro, Manila.

Subject: COVID-19 Active Response and Expenditure Support Program

Dear Mr. Asakawa,

The Royal Government of Bhutan (the Government) would like to thank ADB's proposed support for the Government's efforts in combating the COVID-19 pandemic and protecting the poor and vulnerable, and more specifically to ensuring the country's economy rebound as swiftly as possible in these challenging times. The Government is fully committed in its efforts to respond to the social and economic impacts of the pandemic as outlined by the measures below.

This development policy letter indicates our interest in obtaining a \$20 million loan under the Countercyclical Support Facility using the novel corona virus disease 2019 (COVID-19) Pandemic Response Option (CPRO) for the COVID-19 Active Response and Expenditure Support (CARES) Program. This assistance is much needed for the Government to implement its Economic Contingency Plan (ECP) which is aimed at addressing the adverse social and economic impact from stringent domestic containment and closure measures.

The Government will implement the ECP through three broad approaches: i) social relief package in the form of direct cash transfers to affected individuals which would include displaced employees, unemployed people actively seeking jobs, and self-employed individuals in the informal sector; ii) in the immediate term, fiscal measures to ease cash flow including deferment of Business & Corporate Tax, deferment of Sales Tax and Customs duty on essential imports, and disbursement of funds to procure 6 months' worth of essential commodities reserves for the population, and monetary measures to ease the adverse impact on sectors and mitigate the impact on vulnerable segments of the population including waiver of interest and a loan repayment deferment for 3 months for all businesses and individuals; and iii) targeted interventions involving execution of specific activities to productively engage the economically displaced people.

Post Box No 117. Tel # (PABX: 00975-2-322223/322514/327763/322285).

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**ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG**

The Government has taken an early decision to take proactive measures to prevent the outbreak and spread of the pandemic, following the World Health Organization's declaration of the COVID-19 outbreak as an international public health emergency in January 2020. On January 29, 2020, the Government established a National Contingency Committee, comprising members from the Ministry of Health, Jigme Dorji Wangchuk National Referral Hospital, Royal Centre for Disease Control, WHO Country Office, Department of Disaster Management of the Ministry of Home and Cultural Affairs; Royal Bhutan Police and Department of Livestock. The Committee issued a National Preparedness and Response Plan (NPRP) that covers screening, prevention, isolation and clinical management of the virus in case of an outbreak.

On March 6, 2020, the country reported its first confirmed case of COVID-19 from a foreign tourist who entered the country by air from Paro International airport on March 2, 2020. This milestone rendered Bhutan to activate its preparedness level according to the NPRP into the "Orange Zone" which is described as "moderate disruption", according to which the Government has to isolate confirmed cases. The Government has quarantined suspects; closed schools and academic institutions; and public gatherings in the affected localities. The Government also suspended the issuance of tourist visas, work permits, and clearances to host conferences, seminars, and workshops until further notice. On March 7, 2020, the quarantine and isolation facilities and flu clinics were established across the country. Following the confirmation of the second positive imported case, and the deterioration of situation in the region and the world, the government closed all international land borders to take more drastic measures on March 18, 2020. These include (i) no movement of vehicles across the borders except authorized vehicles, (ii) no Bhutanese allowed to travel out of the country, (iii) all incoming Bhutanese and returned expatriates will be quarantined at designated facilities.

Besides the impact of COVID-19 on the health system, its impact on the economy is expected to be enormous. With restriction of entry into the country, the tourism and allied sectors (airlines, hotels, restaurants, and tour operators) have already been adversely impacted. The tourism sector account for 13% of GDP and provide maximum employment opportunities. In addition, the construction sector is also being affected due to restrictions on entry of foreign construction workers. The impact of foregone revenues from the tourism, allied sectors, and trade will result in decreased tax revenue for the government. Consequently, the fiscal deficit is expected to widen to 5.6% of GDP in FY2020 compared to pre-COVID-19 figures estimate of -3.0%. Moreover, the impact is likely to prolong and spillover into FY2021, given the worsening pandemic situation around the world and in the region.

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**ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG**

In response to the public health risks and adverse economic impacts of COVID-19, the Government will be implementing the Nu30 billion ECP (about \$398.25 million) until FY2021. Given the limited access to resources from domestic capital market, the Government plans to reprioritize its budget and borrow externally from multilateral development partners including ADB to finance the ECP.

The assistance from ADB under the CARES program will be utilized to initiate key outputs such as:(i) relief measures for the most vulnerable implemented through the establishment of the National Resilience Fund and securing six months' worth of essential commodities for the whole population, and (ii) economic stimulus for productive sectors introduced through deferment with 0% interest rate on loans for businesses and individuals for three months until June 2020 (including at least 35% women borrowers) and micro loans of up to Nu0.5 million with a highly concessional rate of 2% for individuals and businesses in the rural and agricultural sectors (including at least 30% women borrowers). The expected outcome of the proposed program will be mitigation of adverse effects of COVID-19 on businesses and the population.

We believe that the ECP and the program, as presented, is the right approach to ensure economic stability in the country. We recognize the challenges and risks entailed in the ECP and are committed to its successful implementation within the next 14 months until June 2021.

Last, the CARES program will help finance the anticipated deficit from the COVID-19 pandemic response and countercyclical support expenditures, as well as the steep decline in revenue collections. We would like to thank ADB for working closely with the Government in developing this program. The Government looks forward to the prompt consideration and approval of the CARES program.

Yours Sincerely,

Lyonpo Namgay Tshering

Post Box No 117. Tel # (PABX: 00975-2-322223/322514/327763/322285).

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**ASSESSMENT OF COMPLIANCE WITH THE COUNTERCYCLICAL SUPPORT FACILITY COVID-19 PANDEMIC RESPONSE
OPTION ACCESS CRITERIA**

CPRO Criteria and Indicators	ADB Staff Assessment
<p>1. Adverse impact of exogenous shock</p>	<p>Expectations of growth rebound shattered. The country was expected to rebound from two consecutive years of lackluster growth that witnessed 3.8% growth in FY2018 and 4.4% in FY 2019. During this period of sluggishness, growth was largely driven by the tourism sector and more broadly by services. The initially anticipated rebound of 6.0% in 2020 was predicated on fiscal expansion as well as robust consumption growth. The COVID-19 pandemic has significantly dampened these prospects. The adverse socioeconomic impacts are also complex.</p> <p>Economic standstill and supply-chain disruptions. The detection of the first case in the country on 6 March 2020 and the rapid escalation globally has warranted stringent preventive measures to contain the spread of COVID-19. These measures have invariably resulted in either an unprecedented decline in economic activity or a complete standstill in the directly affected services sector, including tourism, which accounts for about 43% of GDP. Upon detection of the first case, a restriction on the entry of foreigners by air was imposed. The first sectors to feel the shockwaves were tour operators, hotels and restaurants and transport to some degree. The direct reduction in tourism earnings is estimated to amount to 30% for FY2020. Further restrictions were imposed on 23 March 2020 with the closure of border entry points. This has resulted in significant supply-chain disruptions, especially of imports of goods and labor from India. The construction sector and the manufacturing sector are also affected, facing disruptions in raw material supply. Furthermore, other precautionary measures such as isolation are also dampening demand in the retail sector.</p> <p>Sharp decline in growth and uncertain outlook. The outlook is highly uncertain, with developments suggesting that the pandemic is likely to be protracted. This will severely test the capacity of less developed economies to absorb further shocks for a sustained period. Preliminary forecasts indicate that growth will likely plunge to 1.0%—a 5.0 percentage point reduction from the pre-COVID-19 estimates, translating into GDP loss of over \$176 million. These are perhaps optimistic considering that estimates do not capture the informal sector which is inherently large in a developing country like Bhutan.</p> <p>Inevitable weakening of fiscal position reinforces weak demand. The directly affected services sector has multiple linkages to the rest of the economy; in addition to being employment-intensive, they contribute tax revenue as well as convertible currency. The immediate fiscal impacts because of foregone revenues from tourism royalty, visa fees, and income taxes are estimated to be around Nu887 million (about \$11.8 million). Further, fiscal space will shrink as a result of losses in sales taxes and corporate income taxes. Considering</p>

	<p>that domestic revenue accounts for 20% of GDP, an inevitable weakening in the government's fiscal position will reinforce weak aggregate demand.</p> <p>Increasing financial sector stress. The implications on the financial sector is also apparent. The services sector (including tourism) accounts for 23% of total outstanding credit. With all sources of earnings frozen, defaults are imminent. Other sectors such as wholesale and retail trade with an outstanding debt of 16.5% are likely to come under stress as well. With the sharp recent increase in NPLs to 17.1% in March 2020 compared to 8.2% in December 2019, financial indicators are likely to further breach macro-prudential thresholds.</p> <p>Development plans require reprioritization. The pandemic has also forced a reprioritization of the government's development activities. Considering that growth was expected to receive an impetus from a 51.0% elevation in capital expenditure, the supply disruptions will severely impede infrastructure expansion and other development spending, thereby depressing longer term growth prospects as well.</p> <p>Social implications are deep. The economic shock from the pandemic will hit the poor and the vulnerable including women the hardest and that these groups take the longest to recover. An estimated 11,798 employees in the tourism and allied sectors will be directly affected. The hotels and restaurants in particular have a disproportionately large share of unskilled female employees. The informal sector also engages a large number of unskilled and vulnerable groups such as young school dropouts and migrants from rural areas. With an official youth unemployment rate of 16.0%, a surge in the jobless is inevitable. Likewise, combined employment loss in the services, construction and manufacturing sectors are estimated at around 23,000.</p>
<p>2. Countercyclical Development Expenditures</p>	<p>Expansionary fiscal and monetary measures implemented. While the public health measures have been all encompassing, the government is also rolling out an Economic Contingency Plan to extend relief to affected sectors and employees. To execute this, the National Resilience Fund has been established. An outlay of Nu30,000 million (16.8% of GDP) is being coordinated to extend relief to affected sectors and individuals. To ensure an inclusive intervention that reaches as many of the affected as possible, the government plans to execute its interventions through three broad approaches: (i) social relief, (ii) fiscal and monetary measures, and (iii) targeted interventions involving specific activities targeting the most affected and most vulnerable groups including women while simultaneously contributing to longer-term objectives.</p> <p>Social Relief. A social relief package in the form of direct monthly cash transfers to affected individuals, for an initial period of 3 months (extendable to 12 months depending on the situation). This will involve an outlay of Nu21,665 million. Beneficiaries will include displaced employees, unemployed people actively seeking jobs, self-employed individuals in the informal sector.</p>

	<p>Fiscal and Monetary Measures. The government is coordinating a set of tax interventions in the immediate term. These include a deferment of Business and Corporate Income Taxes and sales taxes for all businesses. While fiscal measures are focused on relief through revenue forgone and targeted expenditure, the government's monetary measures are critical to ensure that there is adequate money in the economy for the business entities to function. These interventions are being coordinated by the Royal Monetary Authority. They include (i) waiver of interest and a repayment deferment for 3 months for all businesses; (ii) subsidized working capital at a preferential rate of 5%; (iii) extension of gestation period for ongoing projects by 3 months (extendable by another 3 months); (iv) working capital through the Cottage and Small Industries (CSI) Bank to CSIs at an interest rate of 4% for a period of 3 months (extendable by another 3 months); and (v) micro-loans through CSI Bank up to a ceiling of Nu0.5 million at an interest rate of 2% for a period of 3 months (extendable by another 3 months).</p> <p>Targeted Intervention. Beyond conventional fiscal measures, the government is also planning to execute targeted projects to engage the displaced in productive activities. This is further contingent on no detection of local transmission, which would otherwise result in a complete lockdown. These targeted interventions will be orchestrated through three domains that target absorbing the displaced in i) tourism infrastructure development and upskilling; ii) food security; and iii) construction. The proposed outlay for these interventions is Nu3,700 million.</p> <p>u</p> <p>In terms of the health response, through a proactive approach, the government prepared the National Preparedness and Response Plan for COVID-19 which aims to enhance the health sector's capacity in surveillance, early detection, control and prevention, response, and recovery from the COVID-19 outbreak in the country. The plan is flexible and being reviewed and updated as and when required by the Technical Advisory Group for COVID-19, Ministry of Health. Given the risks associated with local transmission, the country has managed to achieve its preventive objectives thus far.</p>
<p>3. Pre-shock record of general sound macroeconomic management</p>	<p>Macroeconomic prudence. Bhutan has traditionally demonstrated a strong commitment to macroeconomic prudence.</p> <p>Notwithstanding its high debt, which is also predominantly concentrated in self-liquidating hydropower, the constitution mandates that all recurrent expenditure be financed through domestic resources. This has ensured that any external borrowing is channeled towards either hard infrastructure or economically viable undertakings. The fiscal deficit over the last Five-Year Plan periods since FY1993 has been maintained below 3%. Additional safeguards and prudential limits are reflected in the country's Public Debt Policy 2016. Accordingly, the country has never defaulted on any of its debt obligations exhibiting fiscal reliability.</p>

	<p>On the monetary front, macro-financial prudence in the form of stringent reserve requirements and conservative capital adequacy ratios have enabled a certain level of liquidity buffers.</p> <p>On the external front, the constitution mandates a minimum reserve requirement of 12 months of essential imports. At \$1.1 billion, the country comfortably meets this threshold.</p> <p>The 2016 Public Expenditure and Financial Accountability Assessment observed several improvements through a series of reforms undertaken such as introducing a government e-payment system, and an integration between budget and planning.</p> <p>Furthermore, the government of Bhutan has placed balanced development at the center of its efforts through its development paradigm of Gross National Happiness. Accordingly, there is inherent alignment between the Sustainable Development Goals and Bhutan’s development philosophy of Gross National Happiness.</p>
<p>4. Structural reforms (Health Response)</p>	<p>Public Health Responses. The government has taken decisive and effective responses.</p> <p>Through a proactive approach the National Preparedness and Response Plan for COVID-19 was prepared with the objective to enhance the health sector’s capacity in surveillance, early detection, control and prevention, response, and recovery from the COVID-19 outbreak in the country. The plan is flexible and being reviewed and updated as and when required by the Technical Advisory Group for COVID-19, Ministry of Health.</p> <p>Decisions for these operations are executed by the Health Emergency Management Committee, chaired by the Minister of Health.</p> <p>Bhutan recorded the highest RT-PCR testing rate in the South Asian region at 2,600 per million inhabitants as of 23 April 2020. Given the risks associated with local transmission, the country has managed to achieve its preventive objectives thus far. As a resource-constrained country with limited health facilities—both infrastructure and personnel—an outbreak could easily overwhelm the existing capacity of the system. Moreover, as a society characterized by extended family households, the potential contagion risks are extremely high. Accordingly, the highest standards of preventive measures have been pursued. This has included a publicly financed mandatory quarantine, which was initially 14 days but was extended to 21 days on 1 April 2020. For an enhanced surveillance, all visitors from high risk countries irrespective of symptoms are being tested for laboratory evidence of infection with COVID-19 with effect from 3 April 2020. In the absence of adequate hospital accommodation, the government has used the facilities of unutilized hotel rooms at negotiated rates. As of 23 April 2020, 3,725 returned citizens have undergone quarantine. Of those, 1,843 are still undergoing quarantine. Seven positive cases have been confirmed, three of whom have recovered.</p>

	The Ministry of Health has estimated a budget requirement of Nu1.0 billion for COVID-19 prevention, containment, and treatment from April 2020 to August 2020. Furthermore, an additional Nu2.0 billion has been allocated for health-related response measures consistent with WHO guidelines in preparation for a worst-case scenario.
5. Debt Sustainability	Public debt (public and publicly guaranteed debt) stands at \$2.7 billion, equivalent to 117.0% of GDP in FY2019, of which domestic debt is only 8.9% of GDP in FY2019. The bulk of Bhutan's public external debt is comprised of hydropower projects (74.4%) of which mostly is financed by the Government of India with debt dominated in Indian rupees. These projects are implemented under an intergovernmental agreement in which India covers both financial and construction risks of the projects and buys surplus electricity at a price reflecting cost plus a 15% net return. The remaining 25.6% of non-hydropower debt is modest and owed mostly to ADB and World Bank contracted on highly concessional terms. Though the debt ratio is high, the International Monetary Fund has assessed Bhutan's risk of debt distress as moderate because hydropower debt is essentially self-liquidating through electricity sale agreements. The proposed loan of \$20 million will result in a marginal 0.7% increase in the public debt stock.
6. Coordination with the IMF	Close collaboration. ADB and the IMF coordinate closely through regular dialogue and collaboration on macroeconomic monitoring and assessments. An ADB staff from Bhutan Resident Mission participated as a mission member of the previous IMF on Article IV consultations, which were concluded in July 2018. The updated Article IV consultation mission due in 2020 was postponed from Spring 2020 to Fall 2020. ADB has coordinated with IMF and other development partners including World Bank in designing the CARES program. IMF supports ADB's proposed program and provided the assessment letter on 15 April 2020.

ADB = Asian Development Bank, CARES = COVID-19 Active Response and Expenditure Support Program, COVID-19 = coronavirus disease 2019, GDP = Gross Domestic Product, IMF=International Monetary Fund, NPL = Non-performing Loans, RT-PCR = reverse transcription polymerase chain reaction, WHO = World Health Organization.

Source: ADB staff assessment.