



Report and Recommendation of the President to the Board of Directors

Project Number: 46371-002
May 2015

Proposed Policy-Based Loan, Grant, and Technical Assistance Grant Kingdom of Bhutan: Strengthening Economic Management Program II

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CURRENCY EQUIVALENTS

(as of 6 May 2015)

Currency unit – ngultrum (Nu)

Nu1.00 = \$0.0157

\$1.00 = Nu63.35

ABBREVIATIONS

ADB	–	Asian Development Bank
CIB	–	Credit Information Bureau
DPA	–	Department of Public Accounts, Ministry of Finance
GDP	–	gross domestic product
NPPF	–	National Pension and Provident Fund
RAMIS	–	revenue administration management information system
SEMP I	–	Strengthening Economic Management Program
SEMP II	–	Strengthening Economic Management Program II
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government of Bhutan and its agencies ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2014 ends on 30 June 2014.
- (ii) In this report, “\$” refers to US dollars.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 46371-002	
Project Name	Strengthening Economic Management Program II	Department /Division	SARD/SAPF
Country Borrower	Bhutan Kingdom of Bhutan	Executing Agency	Department of Public Accounts
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		16.28
Finance	Banking systems and nonbank financial institutions		9.98
	Inclusive finance		3.98
	Money and capital markets		6.68
		Total	36.90
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Public financial governance	Some gender elements (SGE)	✓
Private sector development (PSD)	Conducive policy and institutional environment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		36.90	
Sovereign Capacity development technical assistance: Technical Assistance Special Fund		0.70	
Sovereign Program grant: Asian Development Fund		16.10	
Sovereign Program loan: Asian Development Fund		20.10	
Cofinancing		0.00	
None		0.00	
Counterpart		49.30	
Government		49.30	
Total		86.20	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed policy-based loan, and (ii) a proposed policy-based grant, both to the Kingdom of Bhutan for the Strengthening Economic Management Program II (SEMP II). The report also describes the proposed technical assistance (TA) for Supporting Implementation of SEMP II, and if the Board approves the proposed policy-based loan and grant, I, acting under the authority delegated to me by the Board, approve the TA.¹

2. The program will provide budget support for reforms to (i) improve revenue and macroprudential management, and (ii) strengthen financial sector development by targeting capital markets, financial inclusion, and the Credit Information Bureau (CIB). Through these reforms, the program will improve macroeconomic stability in Bhutan.

II. THE PROGRAM

A. Rationale

3. **Past structural and cyclical imbalances and ADB's assistance.** With the hydropower sector driving growth, Bhutan's economy achieved an average annual gross domestic product (GDP) growth rate of 8% during fiscal years (FYs) 2001–2011. Despite the high growth performance, Bhutan faced a major rupee liquidity crunch in FY2012, which exposed critical structural and cyclical imbalances in the economy related to (i) a narrow economic base, (ii) mismatches in revenue flows and debt repayments due to the overreliance on the hydropower development, (iii) credit-driven and import-dependent consumption growth leading to rapid depletion of Indian rupee reserves, and (iv) policy distortions associated with weaknesses in macroeconomic management and financial intermediation.

4. In response to the liquidity crunch, the Government of Bhutan adopted temporary emergency measures such as curtailing credit and import growth. As part of the comprehensive reforms, ADB provided support for the government by financing the Strengthening Economic Management Program (SEMP I) in 2013.² SEMP I successfully helped stabilize the economy, and thereby avoid a prolonged slowdown. The economy grew by 3.5% in FY2013 with an increase in

¹ The design and monitoring framework is in Appendix 1.

² ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Grant to the Kingdom of Bhutan for the Strengthening Economic Management Program*. Manila (L2994/G0338-BHU). SEMP I was successfully completed in July 2014. Major program reforms include strengthening of budget and debt management through preparation of municipal budgets based on the medium-term expenditure framework, and approval of the Medium-Term Debt Management Strategy, and a strategy for the government securities market. For revenue management, the Department of Revenue and Customs piloted the revenue administration management information system (RAMIS). The Ministry of Finance adopted and piloted a new property valuation methodology. For monetary and liquidity management, the Royal Monetary Authority approved macroprudential regulations, credit rating agency regulations, and the Capital Markets Master Plan. For external and internal audit systems, the Royal Audit Authority piloted an audit resource management system, approved an internal audit manual, and completed training of audit staff from the internal audit divisions of the Ministry of Finance and other ministries. The program was supported in part by five TA projects. Assessment of the Strengthening Economic Management Program (accessible from the list of linked documents in Appendix 2).

international reserves—the balance of payments turned to a surplus of 9.5% of GDP in FY2013, from a deficit of 10.7% in FY2012.³

5. **Remaining development constraints.** Despite the success of SEMP I, two critical development constraints need to be addressed.⁴ First, weak institutions and systems for macroeconomic management constrain the government's capacity to effectively manage macroeconomic shocks and mitigate their impact on the economy. The government's capacity needs to be strengthened in this area. Second, the absence of a developed financial sector has constrained private sector development and growth of infrastructure investment. Low investment has led to an undiversified economy that over-relies on the hydropower sector, characterized by low employment generation. Removing policy distortions related to financial intermediation and access to finance is a prerequisite for sustainable economic growth.

6. **Government efforts, ADB's policy dialogue, and development coordination.** Recognizing these critical constraints, the government is fully committed to putting in place more permanent, structural, and corrective measures to strengthen the economy.⁵ These measures would not only provide continuity and deepen earlier reforms under SEMP I, but also revive the economy and lead to a more sustainable and balanced growth model in Bhutan. SEMP II is timely and essential to support the objectives of the government. The reforms proposed under the program address issues related to macroeconomic management and financial sector development.

7. The reforms for improving macroeconomic management will help sustain the recovery and strengthen resilience against potential macroeconomic, financial, and external shocks. This will help minimize volatility and improve macroeconomic stability to achieve sustainable growth. The macroeconomic management reforms have two components.

8. **Revenue management.** Given Bhutan's tax revenue to GDP ratio of 13.2% in FY2014,⁶ there is scope for additional revenue mobilization by improving tax administration and broadening the tax base. This will reduce the dependence on external grants and loans over the medium to long term and a larger share of development outlays could be financed from country's own resources by creating additional fiscal space.

9. **Macroprudential management.** The reforms for macroprudential management are necessary to enhance macrofinancial stability by improving the regulatory framework and providing better supervision of financial system soundness. It is also critical to reduce risks arising from debt spikes due to challenges in forecasting government revenue and expenditure flows; asset–liability mismatches on the banking sector balance sheet; and the hydropower linked procyclicality of bank lending.

³ The overall macroeconomic conditions have stabilized further with GDP growth at 4.0% in FY2014, although it is still below the historic average annual growth rate of 8% during FY2001–FY2011. The fiscal deficit increased to 4% in FY2014 compared with the deficit during the rupee liquidity crunch due to low tax revenue associated with economic slowdown. The current account deficit narrowed slightly. The balance of payments was in a surplus of 5.8% of GDP in FY2014, supported by an increase in official reserves in months of import coverage. Money supply growth and inflation remained stable due to credit restrictions. No major inflationary risks are associated with capital inflows due to the tight monetary policy in FY2014. Country Economic Indicators; and International Monetary Fund Assessment Letter (both accessible from the list of linked documents in Appendix 2).

⁴ The Sector Assessment (Summary) (accessible from the list of linked documents in Appendix 2). These development constraints are also identified in ADB. 2013. *Country Diagnostic Studies. Bhutan: Critical Development Constraints*. Manila.

⁵ The Development Policy Letter is in Appendix 3.

⁶ Indicative Estimate of Impact from Revenue Reforms (accessible from the list of linked documents in Appendix 2).

10. The reforms to strengthen financial sector development under the SEMP II are critical to address the lack of diversification and depth in financial sector, high cost of financial intermediation, lack of long-term financing especially for infrastructure, low savings mobilization, and information asymmetries associated with access to finance. The proposed reforms in this area will complement government's own initiatives such as the Capital Markets Master Plan.⁷ Moreover, in line with government priorities under the Eleventh Five-Year Plan (2013–2018),⁸ improving the business climate for the private sector through better CIB coverage and services is required for Bhutan to lower the country's dependence on the capital-intensive hydropower sector, and diversify its economic base in order to (i) improve its export potential, which could help alleviate the current account deficits; (ii) generate employment; and (iii) achieve poverty reduction goals.⁹

11. The policy matrix of SEMP II was designed in coordination with the World Bank's 2014 development policy credit of \$20 million for Fiscal Sustainability and Investment Climate. The World Bank program focuses on improving the ease of doing business, such as strengthening of electronic property and business registration systems, central asset registry, and investor protection. The two programs are complementary and pursue the common objective of comprehensive private sector development in Bhutan.¹⁰

12. **Reform program and budget support.** The reforms highlighted in the policy matrix (Appendix 4) will facilitate Bhutan's transition to a sustainable and balanced socioeconomic development path. The budget support under SEMP II is necessary to finance part of the projected resource gap (Table 1), particularly covering the period between introduction of reforms, and the time when the reforms gain traction and the full impact of the reforms is realized. The support will temporarily contribute to government spending in areas such as infrastructure and social programs for education and health, until the full impact of the reforms can lead to more sustained development spending.

13. **ADB's value addition.** Through SEMP II, ADB's value addition in Bhutan will be to introduce reforms in the areas of public resource management and financial and private sector development based on its experience and knowledge of international best practices and extensive involvement in similar programs in South Asia. ADB's strength lies in its integrated policy support, which focuses on "how to do it" and covers (i) policy dialogue, (ii) structuring and design of customized policy reforms, (iii) policy implementation support, and (iv) capacity development through technical assistance to ensure sustainability. Very few development partners have the credibility, the means, or the capacity to offer this solutions-based approach, which can effectively adapt best practices to the specific needs and conditions of the Bhutanese economy.¹¹ For example, SEMP II, in addition to the attached TA (paras. 25–26), is supported by three ongoing

⁷ The Capital Markets Master Plan for 2014–2024 was approved by the Ministry of Finance and the Royal Monetary Authority as a policy action under SEMP I.

⁸ Government of Bhutan, Gross National Happiness Commission. 2013. *Eleventh Five-Year Plan (2013–2018)*. Thimphu.

⁹ SEMP II will support the reform initiatives of the government's Doing Business Steering Committee, chaired by the Prime Minister, and the 2014 Improving the Investment Climate in Bhutan Action Plan, both of which target improvement in ease of doing business indicators. In addition, ADB will support the establishment of the Better Business Council in Bhutan under ADB. 2012. *Technical Assistance to the Kingdom of Bhutan for Enhancing Development Management for Sustainable and Inclusive Growth*. Manila. (TA 8229-BHU).

¹⁰ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹¹ Since 2006, ADB approved two major programs (Financial Sector Development Program and Micro, Small, and Medium-Sized Enterprise Sector Development Program [footnote 17]) and 16 TA projects in the areas of public sector management and financial and private sector development, which have built the reform momentum leading to SEMP I and SEMP II. Through these programs, ADB has gained an in-depth understanding of the capacity of Bhutanese institutions to effectively manage reforms. Development Coordination (accessible from the list of linked documents in Appendix 2).

TA projects, which will assist the government in (i) operationalizing the tax administration system under the revenue administration management information system (RAMIS);¹² (ii) implementing macroprudential rules and regulations, and the liquidity management and stress testing framework; and publishing a financial stability report for FY2015;¹³ and (iii) formulating the National Pension Policy and a strategic plan for the National Pension and Provident Fund (NPPF).¹⁴

14. **Alignment with ADB's strategy and lessons learned.** The program is fully aligned with ADB's country partnership strategy, 2014–2018 to improve public sector management, strengthen the financial sector, and promote the private sector development in Bhutan.¹⁵

15. SEMP II draws lessons from ADB's experience with policy-based loans in South Asia¹⁶ and in small economies such as Bhutan and the Maldives,¹⁷ and SEMP I (footnote 2). Three important lessons are that (i) active stakeholder consultation can increase the acceptability and momentum of reforms; (ii) government ownership and commitment are a prerequisite for successful program implementation; and (iii) sustained engagement with government officials, including capacity development, is critical for timely program completion. For the proposed program, aside from the government, consultations with financial sector representatives from the Bankers' Association of Bhutan and civil society organizations, such as the Bhutan Association of Women Entrepreneurs and National Commission for Women and Children, were conducted and stakeholder engagement will continue throughout program implementation.

B. Impact and Outcome

16. The impact of the program will be the achievement of a sustainable growth trajectory for Bhutan. The outcome will be improved macroeconomic stability.

C. Outputs

17. The program will support a policy framework with the corresponding outputs and policy actions, as detailed in the policy matrix (Appendix 4). There are 8 policy actions under the first tranche and 16 policy actions under the second tranche of the program. The institutional development plan under the TA is detailed in paras. 25–26.

18. **Output 1: Improved macroeconomic management.** The program will target following areas of macroeconomic management to sustain the momentum of recovery in the short term and improve the resilience of the economy. To improve revenue collection, administration, and tax service delivery, policy actions will include (i) submission to Parliament of property tax rates based on the property valuation methodology and completion of policies, systems, and processes to

¹² ADB. 2011. *Technical Assistance to the Kingdom of Bhutan for Developing a Revenue Administration Management Information System*. Manila (TA 7881-BHU).

¹³ The preparatory work for these actions, including pilot financial stability report for FY2014, was initiated under ADB. 2012. *Technical Assistance for Supporting Financial Stability in Bhutan and the Maldives*. Manila (TA 8284-REG).

¹⁴ ADB. 2012. *Technical Assistance to the Kingdom of Bhutan for Capital Market Development*. Manila (TA 8280-BHU).

¹⁵ ADB. 2014. *Country Partnership Strategy: Bhutan, 2014–2018*. Manila.

¹⁶ ADB. 2007. *Special Evaluation Study: ADB Support to Public Resource Management in India*. Manila; and M. Attinasi and B. Carrasco. 2008. *Public Resource Management Reform Programs: Do They Work?* Manila: ADB.

¹⁷ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Technical Assistance Loan, and Technical Assistance Grant to the Republic of the Maldives for the Economic Recovery Program*. Manila (Loan 2597-MLD); ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Kingdom of Bhutan for the Financial Sector Development Program*. Manila (Loan 2279/2280-BHU and TA 4885-BHU); ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Grant to the Kingdom of Bhutan for the Micro, Small, and Medium-Sized Enterprise Sector Development Program*. Manila (Grant 0088/0089-BHU).

collect property tax using new rates in Thimphu; (ii) operationalization of direct and sales tax modules of the RAMIS; and (iii) operationalization of a taxpayer information call center based on an approved plan. To enhance financial stability through macroprudential management, policy actions will include (i) publication of a calendar for issuance of government debt securities for FY2017, (ii) notification of disclosure requirements for financial sector balance sheets,¹⁸ (iii) introduction of short-term money market instruments to develop the inter-financial institutions lending market, (iv) assessment through annual onsite inspection of compliance with macroprudential regulations by financial institutions, (v) implementation of liquidity management and a stress testing framework by major banks,¹⁹ (vi) establishment of a committee to monitor financial sector stability, and (vii) publication of a financial stability report for FY2015.

19. **Output 2: Strengthened financial sector development.** The program will strengthen development of the financial sector to rebalance growth by promoting an investment-driven economy in the medium term, and to reorient and diversify the economic base in the long term. For development of capital markets, policy actions will include (i) strengthening of the NPPF through risk-based investment guidelines, Cabinet approval of the National Pension Policy, approval of the NPPF strategic plan, and increase in NPPF membership by at least 5%; (ii) effectiveness of regulations for the public issue of shares; (iii) conducting a feasibility study on establishing a securities and exchange commission; (iv) approval and starting implementation of Bhutanese Accounting Standards and International Financial Reporting Standards;²⁰ and (v) conducting a feasibility study on securitizing Bhutan's hydropower revenues to strengthen the government's capacity for infrastructure financing. For promotion of financial inclusion, policy actions will involve (i) approval of regulations for branchless banking and deposit-taking microfinance, (ii) implementation by the Bhutan Development Bank Limited²¹ of *Gewog* banking services in non-urban areas,²² and (iii) implementation of a financial literacy program with a focus on gender equity. For improving CIB, policy actions will include (i) approval of a regulatory framework for CIB, (ii) establishment of an oversight unit for the credit reporting system, and (iii) approval and implementation of a business plan to strengthen the organization and operation of CIB.

D. Development Financing Needs

20. Bhutan has (i) limited domestic savings to finance investment, (ii) a low tax base for significantly increasing public revenue, and (iii) limitations of fiscal deficit and debt targets under the medium-term fiscal framework. Under the circumstances, the government has adopted a policy of financing its capital and infrastructure expenditures through external concessional loans and grants, while using domestic revenues to finance current expenditure.²³

¹⁸ These enhanced disclosure requirements are in line with Basel III core principles.

¹⁹ A more streamlined framework will be implemented in line with the new prudential liquidity standards of the Basel Committee on Banking Supervision.

²⁰ With the early adoption of an additional 26 Bhutanese Accounting Standards and International Financial Reporting Standards, the standards are harmonized with international norms.

²¹ Bhutan Development Bank Limited provides mobile and branchless financial services, particularly for underserved groups, such as rural women.

²² *Gewog* refers to a group of villages in Bhutan.

²³ Bhutan's debt stock is related to the hydropower development. Capacity addition of 10,000 megawatts is targeted through construction of 10 hydropower projects by 2020. Six of these projects are proposed to be funded under bilateral agreements with India on a 70:30 loan-to-grant basis and four projects are commercial joint ventures between public sector companies in both countries. Based on debt sustainability analysis under SEMP I and the July 2014 IMF Article IV consultation report, Bhutan's debt dynamics (including hydropower loans) are classified as "moderate risk." For the debt portfolio and debt service requirements, there is sufficient hedge against the risks due to favorable financing arrangements with India and strong economic returns from these hydropower projects.

21. In line with this policy, the government's development financing need at the broad macroeconomic level is projected to be \$85.5 million, which is the resource gap between FY2015 and FY2017 (Table 1).²⁴ It is proposed that ADB covers \$36.2 million (42% of the gap) under SEMP II and the remaining \$49.3 million will be financed by the government.²⁵

Table 1: Overall Fiscal Deficit and Development Financing Needs

Item	FY2014 (Revised)	FY2015 (Budget)	FY2016 (Projection)	FY2017 (Projection)	Total FY2015–FY2017
Fiscal balance					
Nu million	(4,601.6)	(3,447.1)	(1,278.2)	135.8	(4,589.5)
\$ million	(77.1)	(53.2)	(18.9)	1.9	(70.1)
Net borrowing					
Nu million	66.2	(1,358.1)	371.6	9.7	(976.9)
\$ million	1.1	(21.0)	5.5	0.1	(15.3)
Resource gap					
Nu million	(4,535.4)	(4,805.2)	(906.6)	145.4	(5,566.4)
\$ million	(76.0)	(74.2)	(13.4)	2.1	(85.5)
Exchange rate					
Nu/\$	59.7	64.8	67.8	70.9	

() = negative, FY = fiscal year.

Note: Revised estimates are as of 31 March 2014.

Sources: FY2014, FY2015, net borrowing and exchange rate are from Government of Bhutan, Ministry of Finance. 2014. *National Budget Financial Year 2014/15*. Thimphu. Fiscal balance and resource gap for FY2016 and FY2017 are Asian Development Bank projections from Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).

22. The government has requested a loan in various currencies equivalent to SDR14,443,000 (\$20.1 million) and a grant not exceeding \$16.1 million from ADB's Special Funds resources to help finance the program.²⁶ The loan will have a 24-year term, including a grace period of 8 years, an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter. The loan and grant will have such other terms and conditions set forth in the draft financing agreement.²⁷

E. Implementation Arrangements

23. The Department of Public Accounts (DPA) of the Ministry of Finance will be the executing agency. It will oversee and coordinate timely implementation of the policy actions. DPA will be responsible for overall administration of the program and the TA, disbursements, and maintenance of all program records. A program steering committee, comprising representatives from the implementing agencies, will be set up and chaired by the secretary and/or joint secretary of the Ministry of Finance.²⁸ It will meet quarterly to monitor progress. ADB will monitor program implementation through periodic progress reports, submitted by DPA, and will field regular missions to confirm the fulfillment of policy actions for tranche releases. ADB and the World Bank

²⁴ The resource gap, which is the sum of the fiscal balance and net borrowing, reflects the financing requirement of the total outlay, which could not be met from available domestic resources including grants and planned net borrowing.

²⁵ Combined with SEMP II, an additional World Bank development policy credit of \$20 million, to be disbursed in FY2016, will finance 66% of the estimated resource gap. The government will then finance the remaining \$29.3 million. For details of the development financing need based on fiscal projections, see Economic and Financial Analysis; and Indicative Estimate of Impact from Revenue Reforms (both accessible from the list of linked documents in Appendix 2).

²⁶ A country's eligibility for Asian Development Fund grants under the revised grant framework is determined by its risk of debt distress. The latest debt sustainability analysis determined that Bhutan has a moderate risk of debt distress and is therefore eligible to receive 50% of its Asian Development Fund allocation as grants.

²⁷ Financing Agreement (accessible from the list of linked documents in Appendix 2).

²⁸ The implementing agencies are Bhutan Development Bank Limited, CIB, the Department of Revenue and Customs, DPA, the Ministry of Finance, NPPF, the Registrar of Companies, and the Royal Monetary Authority.

will continue coordination to ensure no overlap or duplication of activities during program implementation.

24. **Tranches, disbursement, and counterpart funds.** The program has two tranches. The grant will be disbursed as the first tranche upon effectiveness of the draft financing agreement (expected in June 2015), which will be conditional upon achievement of the first tranche policy actions. The loan will be disbursed as the second tranche upon achievement of the second tranche policy actions (expected to be no later than 18 months after disbursement of the first tranche). The proceeds of the loan and the grant will be disbursed in accordance with ADB's simplification of disbursement procedures and related requirements for policy-based loans and grants.²⁹ The proceeds will be used to finance the foreign exchange cost of items produced and procured in ADB member countries, excluding items included in a list of ineligible items and imports financed by other bilateral and multilateral sources.³⁰ Local currency generated from the loan and grant will be deposited into the government's budget fund account with the Bank of Bhutan Limited to provide supplementary financing for the budget. The program will be implemented over a period of 18 months. The disbursement of the loan and grant proceeds will be in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time) and detailed arrangements agreed upon between the government and ADB. ADB will have the right to audit the use of the proceeds and verify the accuracy of the government's certification.

III. TECHNICAL ASSISTANCE

25. The attached capacity development TA is proposed to support program implementation. The TA outputs will mirror major policy actions under the program and strengthen the capacity of key institutions responsible for implementing the reforms.³¹ The TA is estimated to cost \$800,000, of which \$700,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-V). The government will provide counterpart support in the form of counterpart staff, office and housing accommodation, office supplies, secretarial assistance, domestic transportation, and other in-kind contributions.

26. DPA will be the executing agency, and will oversee and coordinate the timely implementation of TA activities through the program steering committee. The TA will be implemented over 18 months from the disbursement of the first tranche (expected in June 2015) until the disbursement of the second tranche (expected no later than December 2016). It will require a total of 15 person-months of international consultancy services and 12 person-months of national consultancy services intermittently. Consultants will be recruited, using the quality- and cost-based selection method with a quality-cost ratio of 90:10 due to the highly specialized expertise needed, in line with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). All disbursements under the TA will be made in accordance with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time). Procurement will be carried out in accordance with ADB's Procurement Guidelines (2013, as amended from time to time).

²⁹ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

³⁰ List of Ineligible Items (accessible from the list of linked documents in Appendix 2). Loan and grant proceeds disbursed against imports will require a certificate from the government stipulating that, in a given year, the value of the total imports of Bhutan, minus its imports from non-member countries, ineligible imports, and imports financed under other official development assistance, is greater than the amount of the loan and the grant expected to be disbursed in such year. ADB will have the right to audit the use of the loan and grant proceeds and to verify the accuracy of the government's certification.

³¹ Attached Technical Assistance (accessible from the list of linked documents in Appendix 2).

IV. DUE DILIGENCE

A. Economic and Financial

27. By enhancing tax collection through modernization of the tax administration with the RAMIS, improving tax compliance and service delivery through a taxpayer information call center, and lowering the dependence of local governments on central transfers through mobilization of revenues from property taxes, the program's revenue management reforms are expected to reinforce a sustainable fiscal trajectory.³² Reflecting the impact of the reforms under SEMP II, domestic revenues are expected to increase progressively by FY2017. The fiscal balance to GDP ratio is projected to improve to a deficit of 0.9% in FY2016 from a deficit of 2.7% in FY2015, and turn to a modest surplus of 0.1% in FY2017 (Table 2). The creation of fiscal space will enable the government to devote more resources on a sustainable basis for capital spending and social programs that are critical for inclusive growth. Revenue management reforms will help Bhutan maintain a smaller resource gap and manage any recurring development financing needs more effectively after program implementation (Table 1).

Table 2: Fiscal Indicators

(\$ million)					
Item	FY2013 (Actual)	FY2014 (Revised)	FY2015 (Budget)	FY2016 Projection	FY2017 Projection
Domestic revenue (tax and non-tax)	355.1	366.5	379.6	397.6	427.1
Current expenditure	304.5	322.9	337.9	358.2	365.0
Capital expenditure	310.1	341.3	234.6	323.7	316.3
Fiscal balance (% of GDP)	(4.1)	(4.0)	(2.7)	(0.9)	0.1
Real GDP growth (%)	3.5	4.0	6.8	5.2	5.1

() = negative, FY = fiscal year, GDP = gross domestic product.

Sources: GDP growth for FY2013 and FY2014 are from Country Economic Indicators (accessible from the list of linked documents in Appendix 2). GDP growth for FY2015, GDP growth projections for FY2016 and FY2017, domestic revenue, current and capital expenditures, and fiscal balance for FY2013, FY2014 and FY2015 are from Government of Bhutan, Ministry of Finance. 2014. *National Budget, Financial Year 2014/2015*. Thimphu. Domestic revenue, current and capital expenditures, and fiscal balance for FY2016 and FY2017 are Asian Development Bank projections from Indicative Estimate of Impact from Revenue Reforms (accessible from the list of linked documents in Appendix 2).

28. Reforms for macroprudential management will enhance financial stability by establishing effective and permanent systems for cash forecasting and domestic debt management, and monitoring of financial indicators through liquidity management, stress testing, and risk-based regulatory and supervisory oversight of financial institutions. These reforms will enable proactive management of macrofinancial risks and improve resilience of the economy against economic shocks. Reforms targeting financial sector development will help rebalance Bhutan's economy toward investment and reorient the economic base to private sector development. The program will strengthen the regulatory and institutional framework for efficient financial intermediation. Introduction of a legal framework for microfinance institutions and branchless banking, outreach of technology-based financial services to underserved communities in rural areas, and a financial literacy program will enhance financial inclusion, and savings mobilization. The strengthening of CIB will improve access to finance and the business climate for entrepreneurs.

B. Governance

29. The governance risk assessment was conducted as part of the ADB's country partnership strategy.³³ The assessment does not identify any serious governance risks related to public

³² Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).

³³ A summary of the governance risk assessment is available in the risk assessment and risk management plan of ADB's country partnership strategy, 2014–2018 for Bhutan (footnote 15).

financial management, procurement, and corruption at the executing level. The program will support policy actions and capacity development that address vulnerabilities for public financial management by (i) improving cash forecasting, including reliable revenue projections; (ii) developing systems for effective debt management, including the government debt securities market; (iii) improving the local and national tax administration; and (iv) strengthening financial stability monitoring, including liquidity management and stress testing of the financial sector. These reforms will strengthen fiduciary arrangements for efficient utilization of public resources. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and DPA. Consistent with its commitment to good governance, implementation of the program will adhere to ADB's Guidelines for Implementing the Second Governance and Anticorruption Action Plan (2014).

C. Poverty and Social

30. Although Bhutan's record of poverty reduction has been strong in the last decade, the improvement of the general quality of life has been accompanied by rising vulnerabilities such as accelerating rural–urban migration, widening income inequality, and rising youth unemployment because of the narrow economic base. In addition, in the absence of a strong social security system, risks of cyclical downturns and external economic shocks have made protection of vulnerable groups more difficult. From this perspective, the program will have a positive impact on poverty and social issues. The program will improve the management of the economy, which is necessary to achieve a stable and sustainable growth trajectory, and in turn allow for effective allocation of public resources to achieve development goals and provide critical public services for the poor and other vulnerable groups such as women. By strengthening financial institutions and CIB, the program will improve the enabling environment for private sector development, which is critical for employment generation and poverty reduction. The program's emphasis on introducing mobile and branchless banking services will extend the reach of financial services to remote areas. The financial literacy program will strengthen the financial inclusion by creating awareness of access to formal financial services among various socioeconomic, demographic, and gender groups in Bhutan; and the culture of savings and responsible personal financial management.³⁴

D. Safeguards

31. Program activities are confined to policy and institutional reforms. None of the activities will result in or lead to involuntary resettlement or affect indigenous peoples. No adverse environmental impacts have been identified. Safeguard categories for environment, involuntary resettlement, and indigenous peoples are all C.

E. Risks and Mitigating Measures

32. The program is categorized as low risk as (i) the size of the program loan is less than \$50 million; (ii) ADB has a sound record with previous experience in the sector in Bhutan; (iii) DPA, the proposed executing agency, has a good performance record for externally financed project implementation; and (iv) the program is unlikely to have any impact on safeguards. The integrated benefits and impacts are expected to outweigh the costs. Major risks that could affect program implementation and mitigating measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.³⁵

³⁴ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

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

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Public financial management	Strengthening of systems and institutions under SEMP II for cash forecasting, debt management, tax administration and financial stability monitoring
Weak implementation capacity of government agencies	Technical assistance provided to improve the capacity of the implementing agencies
Inadequate coordination among government agencies	Establishment of a program steering committee for proper coordination
Trained staff are not retained during program implementation	Engagement with the government to stress the importance of staff continuity and capacity building of junior staff to develop expertise and knowledge at all levels

SEMP II = Strengthening Economic Management Program II.

Source: Asian Development Bank.

V. ASSURANCES AND CONDITIONS

33. 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 draft financing agreement. The government has agreed with ADB on covenants for the program, which are set forth in the draft financing agreement. The grant will become effective after all conditions for the release of the first tranche, as specified in the policy matrix and set out in the draft financing agreement, have been complied with. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

VI. RECOMMENDATION

34. I am satisfied that the proposed policy-based loan and grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the loan in various currencies equivalent to SDR14,443,000 to the Kingdom of Bhutan for the Strengthening Economic Management Program II, from ADB's Special Funds resources, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum 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 financing agreement presented to the Board; and
- (ii) the grant not exceeding \$16,100,000 to the Kingdom of Bhutan, from ADB's Special Funds resources for the Strengthening Economic Management Program II, on terms and conditions that are substantially in accordance with those set forth in the draft financing agreement presented to the Board.

Takehiko Nakao
President

8 May 2015

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact Sustainable growth trajectory	Annual real GDP growth is sustained at not less than 5% by the end of FY2019 (baseline: 4% in FY2014)	For all indicators: MOF annual national budget MOF annual financial statement MOF annual revenue report MOF annual performance indicator report of government RMA monthly statistical bulletins	Assumption The government remains committed to reform measures. Risk Bhutan's medium-term economic outlook is negatively affected by uncertainties in the global economy.
Outcome Improved macroeconomic stability	<p>Gross official reserves in months of merchandise import coverage are sustained at not less than 13 months by the end of Q4 2016 (baseline: 13 months of import coverage in FY2014)</p> <p>Fiscal deficit is within the prescribed level of 3% of GDP by the end of Q4 2016 (baseline: deficit of 4% in FY2014)</p> <p>Non-performing loan ratio of banks reaches 10% or less by the end of Q4 2016 (baseline: 11.8% in September 2014)</p>	For all indicators: RMA statistical bulletin and other government statistics RMA annual report RMA monetary policy statement RMA Bhutanese financial sector performance review National accounts statistics	Assumption Support from development partners continues. Risk Fall in exports and capital flows due to negative shocks to the Indian economy.
Outputs 1. Improved macroeconomic management	<p>A calendar for issuance of government debt securities is published by MOF for FY2017 by the end of Q2 2016 (baseline: not available)</p> <p>Direct and sales tax modules of the RAMIS are launched and become fully operational by the end of Q3 2016 (baseline: not available)</p> <p>An effective liquidity management and stress testing framework for banking sector is developed and implemented by the end of Q3 2016 (baseline: liquidity management system is weak)</p>	For all indicators: MOF national budget of government MOF annual financial statement of government RMA monthly statistical bulletins RMA selected economic indicators	Assumption Trained staff are retained in the relevant departments. Risk Adequate resources and budget support are not available to the implementing agencies to carry out all program activities.

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
2. Strengthened financial sector development	<p>Gender sensitive^a financial literacy program is completed by the end of Q3 2016 (baseline: not available)</p> <p><i>Gewog</i> banking services in non-urban areas, targeting the specific needs of low-income women, are implemented by the end of Q3 2016 (baseline: not available)</p> <p>Users of CIB services (disaggregated by gender) increase by 10% by the end of Q3 2016 (baseline: 33,185 men and 18,478 women obtained credit report from CIB in 2014)</p>	<p>For all indicators:</p> <p>RMA reports</p> <p>Administrative, regulatory, and supervisory guidelines from MoEA, NPPF, RMA, and other relevant agencies</p> <p>Gender-disaggregated data obtained from CIB</p>	
Activities with Milestones			
<p>1. Improved macroeconomic management</p> <p>1.1 Policies, systems, and processes for the collection of property tax within the municipality of Thimphu using the PVM-based property tax rates are prepared by the end of Q4 2015.</p> <p>1.2 DRC completes the development of direct and sales tax modules of the RAMIS by the end of Q1 2016.</p> <p>1.3 DRC prepares a plan to establish a taxpayer information call center by the end of Q1 2015.</p> <p>1.4 MOF prepares revenue and expenditure forecasts for government debt securities issuance calendar by the end of Q1 2016.</p> <p>1.5 RMA prepares guidelines for disclosure requirements under the macroprudential regulations by the end of Q1 2015.</p> <p>1.6 RMA prepares a feasibility study on money market instruments by the end of Q4 2015.</p> <p>1.7 RMA completes the annual onsite inspection of financial institutions to assess compliance with macroprudential regulations by the end of Q2 2016.</p> <p>1.8 RMA provides capacity building to banks on the liquidity management and stress testing framework by the end of Q4 2015.</p> <p>1.9 RMA identifies the staff and prepares the terms of reference of the committee tasked with monitoring financial stability by the end of Q1 2015.</p> <p>1.10 RMA collects and analyzes the macroeconomic and financial indicators to prepare the financial stability report for FY2015 by the end of Q4 2015.</p> <p>2. Strengthened financial sector development</p> <p>2.1 NPPF prepares risk-based investment guidelines by the end of Q1 2015.</p> <p>2.2 NPPF provides capacity building to its staff on asset valuation and actuarial services to support implementation of the National Pension Policy and the NPPF strategic plan by the end of Q2 2016.</p> <p>2.3 MoEA drafts the regulations for public issue of shares by the end of Q1 2015.</p> <p>2.4 MoEA and RMA prepare a feasibility study on the establishment of a separate securities and exchange commission by the end of Q2 2016.</p> <p>2.5 MOF, in coordination with the Accounting and Auditing Standards Board of Bhutan, prepares guidelines to harmonize the accounting and financial</p>			<p>Inputs</p> <p>Grant ADB: \$16.1 million</p> <p>Loan ADB: \$20.1 million</p> <p>Technical Assistance ADB: \$700,000</p> <p>Government: \$49.3 million</p>

Activities with Milestones	
<p>reporting standards with international norms by the end of Q1 2015.</p> <p>2.6 MOF prepares a feasibility study on securitization of hydropower revenues by the end of Q2 2016.</p> <p>2.7 RMA drafts regulations on branchless banking and deposit-taking microfinance to improve financial inclusion by the end of Q2 2016.</p> <p>2.8 Bhutan Development Bank Limited prepares a feasibility study and action plan to introduce <i>Gewog</i> mobile and branchless banking services in non-urban areas by the end of Q2 2015.</p> <p>2.9 RMA prepares a plan for a gender-focused financial literacy program in consultation with stakeholders by the end of Q4 2015.</p> <p>2.10 RMA drafts regulations for the credit reporting system to improve CIB by the end of Q1 2015.</p> <p>2.11 RMA or other relevant regulator identifies the staff and prepares the terms of reference of the oversight unit for the credit reporting system by the end of Q2 2016.</p> <p>2.12 CIB prepares a business plan by the end of Q1 2015.</p>	

ADB = Asian Development Bank, CIB = Credit Information Bureau, DRC = Department of Revenue and Customs, GDP = gross domestic product, MoEA = Ministry of Economic Affairs, MOF = Ministry of Finance, NPPF = National Pension and Provident Fund, PVM = property valuation methodology, RAMIS = revenue administration management information system, RMA = Royal Monetary Authority.

^a Gender sensitive means the financial literacy campaign materials (i) take into account both women's and men's interests and needs, (ii) are presented in such a way that both women and men can understand the information being communicated, and (iii) are communicated through adequate channels to reach out to both women and men. It also means materials do not contain content or images that reinforce gender stereotypes.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://adb.org/Documents/RRPs/?id=46371-002-3>

1. Financing Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Attached Technical Assistance
6. Economic and Financial Analysis
7. Country Economic Indicators
8. International Monetary Fund Assessment Letter
9. Summary Poverty Reduction and Social Strategy
10. Risk Assessment and Risk Management Plan
11. List of Ineligible Items

Supplementary Document

12. Assessment of the Strengthening Economic Management Program
13. Indicative Estimate of Impact from Revenue Reforms

DEVELOPMENT POLICY LETTER



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ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG



DPA/ADB/SEMP II/2015/ 3320
March 25, 2015

Mr. Takehiko Nakao
President
Asian Development Bank
Manila

Dear Mr. Nakao,

The Royal Government of Bhutan (the Government) would like to thank ADB for approval and swift implementation of the Strengthening Economic Management Program (SEMP I) that contributed to the successful stabilization of the Bhutanese economy following the rupee liquidity crunch. Going forward, the Government is fully committed to achieve sustainable and balanced growth in Bhutan and therefore puts importance on improving its management of the economy in line with the best practices for developing the resilience against economic shocks and maintaining the momentum of recovery, and on strengthening the financial sector intermediation for rebalancing the economy towards investment-driven activities, and reorienting and diversifying the economic base through private sector development. The Government recognizes that these reforms are essential to meet the development priorities such as employment generation.

In the medium term, and to contribute towards the attainment of the desired outcomes, our strategy is primarily centered on (i) improving macroeconomic management, and (ii) strengthening financial sector development. I am confident that these initiatives can help the country augment and sustain the development financing.

Development Finance Reform Program

The program that we seek to put in place, with the assistance of Asian Development Bank (ADB), will help us address the strategic areas of focus as stated above. More specifically, ADB's support will be utilized to initiate key reforms in the following areas:

- (i) **Improved macroeconomic management.** The following areas of macroeconomic management will be targeted to sustain the momentum of recovery and improve the resilience of the economy. For improved revenue collection, administration and tax service delivery, policy actions will include (a) submission to Parliament of property tax rates based on PVM and completion of policies, systems and processes to collect property tax using new rates in Thimphu, (b) operationalization of direct tax and sales modules of RAMIS, and (c) operationalization of tax payer information call center based on an approved plan. For enhancing financial stability through macroprudential management, policy actions will include (a) publication of a calendar for issuance of government debt securities for FY2017, (b) disclosure



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**ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
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requirements for financial sector balance sheets, (c) introduction of short-term money market instruments to develop the inter-financial institutions lending market, (d) annual onsite inspection to assess the compliance of macroprudential regulations by the financial institutions, (e) implementation of liquidity management and stress testing framework by major banks, (f) establishment of a committee to monitor financial sector stability, and (g) publication of the financial stability report for FY2015.

- (ii) **Strengthened financial sector development.** The program will strengthen the financial sector development in Bhutan to rebalance the growth by promoting investment-driven economy in the medium-term and to reorient and diversify the economic base in the long term. For development of capital markets, policy actions will include (a) strengthening of the National Pension and Provident Fund (NPPF) through risk-based investment guidelines, Cabinet approval of the National Pension Policy, approval of NPPF strategic plan, and increase in NPPF membership by at least 5%; (b) effectiveness of regulations for the public issue of shares; (c) a feasibility study on establishing a securities and exchange commission; (d) approval and starting implementation of the Bhutanese Accounting Standards (BAS) and International Financial Reporting Standards (IFRS); and (e) a feasibility study on securitizing Bhutan's hydropower revenues to strengthen government's capacity on infrastructure financing. For promotion of financial inclusion, policy actions will involve (a) approval of regulations on branchless banking and deposit-taking microfinance, (b) implementation by the Bhutan Development Bank Ltd. (BDBL) of Gewog banking services in non-urban areas, and (c) implementation of financial literacy program with a focus on gender equity. Finally, to improve access to finance and strengthen the enabling business environment for entrepreneurs, policy actions will include (a) approval of regulatory framework for the credit information bureau, (b) establishment of an oversight unit for the credit reporting system, and (c) approval and implementation of a business plan to strengthen the organization and operations of the credit information bureau.

The outcome of the proposed program will be improved macroeconomic stability. The outcome will be monitored in line with the program impact and outcome indicators agreed upon with ADB.

We believe that the program, as presented, is the right approach to economic reforms in Bhutan and can be implemented in 18 months. We recognize the challenges and risks entailed in this program, but remain fully committed to its timely implementation. The piggybacked technical assistance will make an important contribution during the implementation of the program in overcoming the capacity constraints of the implementing agencies. We confirm that the Policy Matrix that accompanies this letter is reflective of and fully in consonance with the reform agenda of the Government.



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TASHICHHO DZONG**



We would like to thank ADB for working closely with the Government in developing this program and would like to reiterate our full support for it.

Yours sincerely,


Lam Dorji
SECRETARY

POLICY MATRIX
STRENGTHENING ECONOMIC MANAGEMENT PROGRAM II (SEMP II)

Objective: To achieve sustainable growth trajectory through improved macroeconomic and financial management.

1 st Tranche Policy Action (by Q1 2015)	2 nd Tranche Policy Action (18 months after T1)
Output 1: Improved Macroeconomic Management Short-Term Objective: To continue and deepen the macroeconomic management reforms in order to sustain the momentum of recovery and improve the resilience of the economy.	
A. Strengthening Revenue Management	
	(1) ** The property tax rates based on the property valuation methodology will have been submitted to Parliament, and the policies, systems and processes which are necessary to collect property tax using the new rates will have been completed within the municipality of Thimphu. (Document required: (i) Letter from National Assembly Secretariat confirming receipt of the property tax rates, and (ii) status report on the completion of property tax policies, systems and processes, certified by the Director of DRC)
	(2) DRC will have operationalized the direct and sales tax modules of RAMIS. (Document required: Report on the operationalization of the tax modules of RAMIS, certified by the Director of DRC)
(1) DRC will have approved a plan to establish a taxpayer information call center, including taxpayer services to be provided, and staff, budget, and IT infrastructure requirements. (Document required: Plan, certified by Director of DRC)	(3) ** The taxpayer information call center will have become operational. (Document required: Status report on the operation of the taxpayer information call center, certified by the Director of DRC)
B. Enhancing Financial Stability through Macprudential Management	
	(4) ** MOF will have i) published a calendar for issuance of government debt securities for FY2017 and ii) issued government debt securities following the calendar. (Document required: i) Calendar for FY2017, certified by the Secretary of the MOF and ii) Letter from the Secretary of MOF that issuances in FY2017 were conducted in accordance with the calendar.)
(2) RMA will have notified the public of the disclosure requirements under its macroprudential regulations. (Document required: Notification of the Disclosure Requirements, certified by the Governor of RMA)	(5) RMA will have notified financial institutions of new money market instruments to develop the inter-financial institutions lending market. (Document required: Notification on the new money market instruments, certified by the Governor of RMA)
	(6) RMA will, as part of the annual onsite inspection, have assessed the compliance with the macroprudential regulations for at least three financial institutions. (Document required: Inspection report, certified by the Governor of RMA)

1 st Tranche Policy Action (by Q1 2015)	2 nd Tranche Policy Action (18 months after T1)
	(7) RMA will have prepared an assessment report on the implementation of its liquidity management and stress testing framework by the Bank of Bhutan Limited and Bhutan National Bank Limited. (Document required: Assessment report, certified by the Governor of RMA)
(3) RMA will have established a committee tasked with monitoring the stability of the financial sector. (Document required: Letter from the Governor of RMA, stating that the committee has been established, members and terms of reference)	(8) RMA will have published a financial stability report in 2016 for FY2015. (Document required: Financial stability report, certified by the Governor of RMA)
Output 2: Strengthened Financial Sector Development Medium-Long-Term Objective: To promote investment-driven economy in order to rebalance the growth, and to reorient and diversify the economic base.	
C. Developing the Capital Markets	
(4) ** The NPPF Board will have approved risk-based investment guidelines. (Document required: A copy of the investment guidelines, certified by the Chief Executive Officer of the NPPF)	(9) (i) The National Pension Policy will have been approved by the Cabinet, and the NPPF Board will have approved the Strategic Plan, and (ii) NPPF will have increased its membership by at least 5%. Document required: i) National Pension Policy certified by the Cabinet Secretariat as having been approved by the Cabinet, and NPPF Strategic Plan, certified by the Chief Executive Officer of NPPF as having been approved by the NPPF Board, and ii) Letter from the Chief Executive Officer of NPPF certifying the increase in membership.
(5) Regulations for the public issue of shares will have become effective. (Document required: i) Letter of the Registrar of Companies stating that the regulations have become effective and ii) Copy of the Regulations, certified by the Registrar of Companies.)	(10) ** The Prospectus Approval Committee under the Registrar of Companies (comprising, among others, representatives of the MoEA and RMA) will have prepared a report on the legal, regulatory, and institutional requirements for, and feasibility of, establishing a separate securities exchange commission. (Document required: Report certified by the Registrar of Companies)
(6) MOF will have approved and started implementation of the Bhutanese Accounting Standards (BAS) / International Financial Reporting Standards (IFRS). (Document required: Letter from the Minister of the MOF stating that the BAS/IFRS have been approved)	
	(11) ** Based on its review of international experience, MOF will have prepared a report on the legal, regulatory, and institutional requirements for, and feasibility of, securitization of Bhutan's hydropower revenues. (Document required: Report, certified by the Secretary of the MOF)

1 st Tranche Policy Action (by Q1 2015)	2 nd Tranche Policy Action (18 months after T1)
D. Promoting Financial Inclusion	
	(12) RMA will have approved a regulatory and supervisory framework to improve financial inclusion, and adopted regulations such as branchless banking and deposit-taking microfinance. (Document required: i) Regulations comprising the regulatory and supervisory framework, certified by the Governor of RMA and ii) Letter from the Governor of RMA certifying that the regulations have been adopted.)
	(13) ** Bhutan Development Bank Limited will have substantially implemented Gewog banking services in non-urban areas. (Document required: Status report on the implementation, certified by the Managing Director of BDBL)
	(14) ** RMA will have developed and implemented a financial literacy program in consultation with stakeholders with a focus on gender equity. (Document required: Report on the implementation of the financial literacy program, certified by Governor of RMA)
E. Improving the Credit Information Bureau	
(7) RMA will have approved regulations which will (i) govern the establishment, organization and operation of a credit reporting system; (ii) establish the conditions for credit reporting and (iii) specify the roles of participants, and other relevant information. (Document required: Regulations, certified by the Governor of the RMA)	(15) An oversight unit for the credit reporting system will have been established. (Document required: i) Circular/order on the establishment of the oversight unit, and ii) Attachment on the composition and terms of reference of the oversight unit, both certified by the Governor of RMA or other relevant regulator)
(8) Credit Information Bureau (CIB) will have approved a business plan, including new products and services, projected budget, staffing needs, upgrades of IT infrastructure, and other organizational issues. (Document required: Business plan, certified by the Chief Executive Officer of the CIB)	(16) ** CIB will have substantially implemented the business plan. (Document required: Status report on the implementation, certified by the Chief Executive Officer of the CIB)

Note: Piggybacked TA support will be provided for policy actions with **.

BAS = Bhutanese Accounting Standards, BDBL = Bhutan Development Bank Limited, CIB = Credit Information Bureau, DRC = Department of Revenue and Customs, IFRS = International Financial Reporting Standards, MoEA = Ministry of Economic Affairs, MOF = Ministry of Finance, NPPF = National Pension and Provident Fund, RAMIS = Revenue Administration Management Information System, RMA = Royal Monetary Authority.

Source: Asian Development Bank.