

**PROGRAM INFORMATION DOCUMENT (PID)  
CONCEPT STAGE**

Report No. 90298

<b>Project Name</b>	<b>Fiscal Sustainability and Investment Climate</b>
<b>Region</b>	<b>South Asia</b>
<b>Country</b>	<b>Bhutan</b>
<b>Sector</b>	<b>Central Government Administration (100%)</b>
<b>Project ID</b>	<b>P147806</b>
<b>Lending Instrument</b>	<b>Development Policy Lending</b>
<b>Borrower(s)</b>	<b>Royal Government of Bhutan</b>
<b>Implementing Agency</b>	<b>Ministry of Finance</b>
<b>Date PID Prepared</b>	<b>August 27, 2014</b>
<b>Estimated Date of Appraisal Authorization</b>	<b>October 10, 2014</b>
<b>Estimated Date of Board Approval</b>	<b>Dec 16, 2014</b>
<b>Corporate Review Decision</b>	<b>Following the corporate review, the decision was taken to proceed with the preparation of the operation.</b>

**I. Key development issues and rationale for Bank involvement**

Bhutan's economy is on the rise with an average annual growth rate between 7-8 percent for the past five years. Hydropower is estimated to contribute one-third of GDP, and one-fifth of economic growth, including direct and spillover activities. Bhutan is now a lower middle income country (MIC) with a unique poverty reduction record in international context and is well on track towards achieving MDGs. Hydropower development, better tourism performance and improved farm productivity lead the country's economic growth.

While Bhutan's macroeconomic outlook is positive – macroeconomic pressures on domestic demand will have to be managed by adopting tightened policy stance. Bhutan has been facing growing external imbalances- with a current account deficit stands at 15 percent of GDP, even after the hydropower exports. This large external deficit is matched by a current fiscal deficit financed by grants and loans. Several factors contributed to these imbalances. These included loose macroeconomic and fiscal policies, as well as rapid credit growth which have led to higher imports and increased vulnerabilities of the financial sector. The external pressures have led to recurrent shortfall in Indian rupee reserves and the Government had to resort short term fixes. Bhutan needs a comprehensive set of measures to ensure macroeconomic as well as fiscal and financial sector sustainability. These policies need to be accompanied by reforms to ensure a better investment climate that is more conducive to private sector development to help Bhutan achieve its private sector led growth strategy.

Fiscal Sustainability and Investment Climate DPC is designed to support Bhutan's fiscally sustainable development strategy. The DPC series underpins two objectives of the new Country Partnership Strategy (CPS FY15-19): Improving fiscal and spending efficiency and Increasing private sector growth and competitiveness.

**II. Proposed objective(s)**

The DPC intends to support the fiscal discipline and private sector growth in Bhutan. This will be accomplished through by: (i) fiscal tools to manage consumption demand; (ii) enhancing access to finance to businesses and (iii) improving the investment climate for business entry, investment and growth in Bhutan. The DPC support's Bhutan's Eleventh Five Year Plan (2013-2018) and in particular it's sustainable and equitable socio-economic development pillar. The DPC will support the key pillar of macro-fiscal and investment climate components of the Government's program.

### **III. Preliminary description**

The DPC is anchored in 10 prior actions, structured around three pillars. The first pillar focuses on actions that are necessary to ensure a better macroeconomic sustainability and fiscal governance to address the dual deficits of fiscal accounts and external current accounts. The second pillar focuses on ensuring that enterprises, especially micro, small and medium enterprises (MSMEs) have access to finance to invest in their operations and grow the economy. The third pillar supports improving the investment climate for businesses to be created, make investments and ultimately create jobs.

The credit will support the following specific policy areas:

- (i) Prevailing restrictions on imports are to be replaced with fiscal tools such as levying taxes on imports of discretionary goods.
- (ii) Amendment of movable and immovable property Act and to facilitate the use of movable assets as collateral.
- (iii) Royal Monetary Authority (RMA) revises Credit Information Bureau (CIB) guidelines to include information from other non-bank financial companies.
- (iv) Digitization of property registry to provide an up to date land information system and land titles to be used by financial institutions to extend loans.
- (v) Regulations for Collateral Registry to be approved by RMA to allow all movable collaterals to be registered and used for bank loans.
- (vi) Approval of Business Licensing Policy to create a level playing field for all firms and encourage business to participate in the formal economy leading to better expansion opportunities.
- (vii) Approval of Company Act Amendments to make it faster and less costly for a company to get established. This will include eliminating the requirement for a company seal among other amendments.
- (viii) Approval of Enterprise Registration Bill that includes adoption of a single business identification number for all businesses and one-stop shop for enterprise registration.
- (ix) Reduction in the cost and time of acquiring a construction permit by: (i) making the building permit application from available at no cost; (ii) reducing fees for the building permit; (iii) issuing the occupancy certificate on the spot for low-risk projects in full compliance at the time of final inspection.
- (x) PPP mechanism is created by executive order to improve the dialogue on policy reforms that improve the environment for doing business.

### **IV. Poverty and Social Impacts and Environment Aspects**

#### *Poverty and Social Impacts:*

The poverty and social impacts of policy measures supported by the DPC series are expected to be positive. No negative impact is anticipated. The first policy area is expected to create fiscal space, which in turn will contribute to macroeconomic sustainability and stability, a prerequisite for any (pro-poor) policy and economic reforms. The creation of the stabilization fund which contributes to smoothing

revenues and expenditures over time and to public investment decisions will contribute to share prosperity. The second pillar aims to improve the investment climate to ultimately increase private investment in the country. The actions supported by the second pillar aim to enhance access to credit to support the development of the private sector and create an enabling environment for private enterprise. In urban areas more job opportunities from the private sector is a priority to improve livelihoods, absorb new labor market entrants and strengthen social cohesion. Creating an enabling environment for firms to operate in Bhutan is the aim of the third pillar and reforms that aim at creating jobs through development of private sector will have the positive social impact because of enhanced employment opportunities.

*Environment Aspects:*

The proposed DPC series is not expected to have any environmental impact. Measures to promote fiscal and public financial management improvement as well as financial sector development are expected to be environmentally neutral and so it is a better investment climate. Bhutan has adequate legislative cover, policy guidelines and institutional mechanisms in place for managing the environment.

**V. Tentative Financing** *(Automatically pulled from the AUS)*

Source	(\$m)
BORROWER/RECIPIENT	0
International Development Association	20

**VI. Contact Point**

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