



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 20-Feb-2018 | Report No: 124522



BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kingdom of Bhutan	P164290	Bhutan Programmatic DPC Series	
Region	Estimated Board Date	Practice Area (Lead)(s)	Financing Instrument
South Asia	March 30, 2018	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Royal Government of Bhutan	Ministry of Finance		

Proposed Development Objective(s)

The objective is to:

- i) Strengthen the policy framework to improve fiscal management
- ii) Enhance policies to promote private sector employment opportunities

Financing (in US\$, Millions)

SUMMARY

Total Financing	30
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DETAILS

IDA-18 Financing

Decision

Decision Meeting authorize the team to appraise and negotiate this DPC.



B. Introduction and Context

Country Context

Since Butan's political transition in 2008, the country has developed a reputable and unique system for management of public policies. Bhutan underwent a smooth political transition from an absolute monarchy to a democratic constitutional monarchy in 2008. In addition, the country developed a comprehensive system for management of public policies founded on the principles of Gross National Happiness (GNH). Rooted in the Constitution, medium and long-term strategies, robust annual budget process, and annual performance agreements with the civil service, GNH Commission serves a central role in ensuring compliance of the public policies and processes with principles of GNH. The core four principles of GNH are: (i) good governance; (ii) sustainable socio-economic development; (iii) preservation and promotion of culture; and (iv) environmental conservation. Every policy is screened for compliance with these principles and extensive public consultations with relevant government stakeholders are carried out prior to the adoption.

As Bhutan has opened itself to the world, its economy has been transformed by the growth in hydropower and tourism, resulting in rapid economic growth and declines in poverty. Between 2000 and 2016, Bhutan's per capita gross domestic product (GDP) almost doubled to US\$2,800. Bhutan has almost eliminated extreme poverty, with estimates indicating that just 2 percent of the population live on less than US\$1.90 a day, which is the second lowest level of poverty in South Asia and substantially lower than the regional average of 19 percent. Similarly, the national poverty rate has declined from 12 percent in 2012 to 8 percent in 2017. Bhutan's economy has also shared the benefits of increasing prosperity. Between 2000 and 2015, the average income and expenditure of the bottom 40 percent of the distribution grew at the same rate as the overall average.

Current political environment is stable, and overall risks to the operation are moderate. Since the political transition in 2008, Bhutan has held two free and fair general elections and the third one is scheduled in 2018, which puts its after first and second operations of the programmatic series. The government also engages in participatory processes that include members of the opposition party in formulating development strategies, such as the ongoing preparation of the 12th FYP. While political will at the highest level is strong, reform momentum could potentially falter in the run-up to the elections as the government's decision-making process will likely become more risk-averse, with major reforms getting delayed.

Relationship to CPF

This DPC series underpins all three objectives of the Country Partnership Strategy (FY2015-19): (i) improving fiscal and spending efficiency; (ii) increasing private sector and competitiveness; and (iii) supporting green development. The DPC is designed to have a strong impact on economic growth through a renewed focus on private sector development by creating the enabling environment to generate more jobs. While on the fiscal front, this operation looks to support measures to create the fiscal space through greater revenue enhancing policies and ensure quality of spending through PFM system reforms.

This Operation fully supports progress towards the WBG's twin goals in Bhutan. This operation seeks to help Bhutan increase its competitiveness which will enable Bhutan to absorb its growing population into the workplace. By supporting policies which help to create more and better jobs while still protecting Bhutan's national assets, this operation will not only help to continue to support Bhutan's recent gains in poverty reduction, but also help WBG meet its commitment to climate change and gender equality.



C. Proposed Development Objective(s)

The objective is to: i) strengthen the policy framework to improve fiscal management, and ii) enhance policies to promote private sector employment opportunities

Key Results

Pillar 1:

1. Stabilization Fund operational and members of the Governing Board of the Stabilization Fund have been appointed. Baseline (2016): 0; Target (2021): All.
2. GST Law adopted and revenues collected. Baseline (2016): BTN 0; Target (2021): BTN 4,000 million
3. Number of PFM systems interconnected. Baseline (2016): 0; Target (2021): 5

Pillar 2:

1. Number of CSIs under incubation: Baseline (2016): 7; Target (2021): 30
2. Number of entities reporting to CIB. Baseline (2016): 988; Target (2021): 1,087
3. Percentage of Teachers meeting new Teachers' Standards. Baseline (2016): 0 percent; Target (2021): 15 percent.
4. Energy Efficiency Policy reducing energy consumption in tons of oil equivalent (TOE):
 - i) Building & appliance sectors: Baseline 2014: 270,356 TOE; Target 2021: 8,000 TOE reduction
 - ii) Industry Sector: Baseline 2014: 241,972 TOE; Target 2021: 15,000 TOE reduction
 - iii) Transport Sector: Baseline 2014: 121,218 TOE; Target 2021: 7,000 TOE reduction

D. Program Description

The proposed Development Policy Credit (DPC) of US\$30 million is the first in a programmatic series of three operations that aim to strengthen policy framework to improve fiscal management and enhance policies to promote private sector employment opportunities in Bhutan. Bhutan is one of the smallest but fastest-growing economies in the world with an annual average growth rate of 7.6 percent over the past three decades. This stellar growth performance has helped improve living standards and has contributed to poverty reduction. However, further welfare improvements will require a dynamic job-creating private sector. The current hydropower driven growth model has created some macroeconomic imbalances and coupled with a large and dominant public sector, impeded the development of a vibrant private sector. As a result, the economy has witnessed considerable volatility, and limited job creation. This DPC series will help the government address some of these challenges by supporting reforms aimed at improving the management of macroeconomic volatility, strengthening domestic resource mobilization, and promoting employment opportunities in the private sector. The DPC series is also consistent with Bhutan's 11th (2013-18) and 12th Five Year Plans (FYP) (2018-24).

E. Implementation

Institutional and Implementation Arrangements

The World Bank works closely with the Prime Minister's office, Ministry of Finance, Ministry of Economic Affairs, Gross National Happiness Commission, Royal Monetary Authority and other relevant ministries to monitor and assess the reform progress and impacts during operation. The Ministry of Finance monitors progress of fiscal indicators both through their annual budget report and their performance agreement signed with the Prime Minister.



F. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The majority of prior actions will have either neutral or a long-term positive impact. Establishment of the stabilization fund (Prior Action 1) should not have direct effect on poverty but may have indirect but positive effects in the future with stabilized macroeconomic conditions and improved transparency and accountability. Supporting Business Incubation Center for CSI (Prior Action 4) and RNR Marketing Policy for agricultural products (Prior Action 5) should help RGOB to create an enabling environment for small enterprises and potential entrepreneurs to grow, and likely contribute to job creation in the long run. Support to CIB rules and regulations amendment (Prior Action 6) and E-money issuer rules and regulations (Prior Action 7) intend to mitigate insufficient access to finance. These reforms should contribute to positive effects on poverty reduction to the extent that they contribute to job creation for those otherwise unemployed and poor. The introduction of International School Guidelines (Prior Action 8) should have no effect on poverty as public education is already free and international schools when introduced will target wealthier households.

However, some prior actions could potentially have effects on the poor and the bottom 40 percent. The introduction of GST bill under Prior Action 2 is likely to have a significant short to medium term effect on the consumption patterns of the poor and the bottom 40 percent. The magnitude of the effect is unknown at this point as it will depend on how the overall GST scheme and key elements are designed, including but not limited to eligible items and tax rates. It is strongly recommended that a Poverty and Social Impact Analysis be conducted as RGOB designs the fine detail of the GST scheme.

Environmental Aspects

Policies supported by this operation are not expected to have significant negative environmental effects on the country's environment, forests and other natural resources. There could be minor negative environmental effects pertaining to the policies / guidelines pertaining to facilitating CSIs, promoting RNR-based agricultural products and establishing international schools (see Annex 4). However, these minor effects, if any, are expected to be mitigated thanks to the RGoB's country environmental system.

In terms of RGoB's country environmental system, the National Environment Protection Act 2007 is the overarching umbrella legislation that governs the use of land, water, forests, minerals and other natural resources. This provides for the effective system to conserve and protection through NEC and other specified authorities / committees to independently regulate and promote sustainable development in an equitable manner. Other relevant regulations include the Environmental Assessment Act 2000 and its clearance regulation amended till 2016, Waste Prevention and Management Act 2009 & its Regulations amended till 2016, Water Act 2011 and its Regulation amended till 2014 and the Listed & Exempted Activities 2016. Together these legislations and regulations and the relevant institutions constitute the country's environmental systems. These existing systems would be able to address the above mentioned minor distributional environmental effects, particularly considering that the likelihood and its severity are low. There are no gaps or shortcomings in the country systems that are required to address these effects.

G. Risks and Mitigation

The overall risk rating for this operation is moderate. Among the listed categories, (i) political and governance, (ii) macroeconomic, (iii) sector strategies and policies, (iv) fiduciary, and (v) stakeholder risks are deemed moderate, while



environmental and social risks are low (Table 5). The political governance risk is moderate. The next general election is scheduled in mid-2018 which puts its after first and second operations of the programmatic series. The government also engages in participatory processes that include members of the opposition party in formulating development strategies, such as the ongoing preparation of the 12th FYP. Macroeconomic risk is moderate, as described in Section 2 on the assessment of macroeconomic policy. On fiduciary risk, the 2016 PEFA assessment confirmed significant improvement in most aspects from 2010. However, the risk ratings for technical design of project or program and institutional capacity or implementation and sustainability are substantial

CONTACT POINT

World Bank

Contact: Damir Cosic
Title: Senior Economist
Tel: +975-17-124-534
Email: dcosic@worldbank.org
Location: Thimphu, Bhutan

Borrower/Client/Recipient

Contact: Nim Dorji
Title: Secretary, Ministry of Finance
Tel: +975-2-322223
Email: ndorji@mof.gov.bt
Location: Thimphu, Bhutan

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader:	Damir Cosic, Senior Economist
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Approved By

Country Director:	Qimiao Fan	2/28/2018
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