

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

August 23, 2017
Report No.: 119077

Operation Name	Improving Fiscal Management & Strengthening Private Sector Employment DPC
Region	South Asia
Country	Bhutan
Sector	Central Government (Central Agencies) (100%)
Operation ID	P164290
Lending Instrument	Development Policy Credit
Borrower(s)	Royal Government of Bhutan
Implementing Agency	Ministry of Finance
Date PID Prepared	August 7, 2017
Estimated Date of Appraisal	December 2017
Estimated Date of Board Approval	Q3 FY2018
Corporate Review Decision	Following the concept review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

The proposed Development Policy Credit operation supports Bhutan's efforts to improve fiscal management and strengthen private sector employment opportunities. Bhutan has been one of the fastest growing countries in the South Asia region with growth averaging at above 7 percent over the last decade. High economic growth has also helped the country reduce poverty (national poverty rate) down from 23 percent in 2007 to 12 percent in 2012. Growth has also been broad based with per capita expenditures of the bottom 40 percent of the population growing at the same rate as other overall average between 2007 and 2012.

The high growth has been driven by large public sector investment mainly in hydropower. The hydropower sector will continue to play a key role in economic development. The government plans to triple hydropower generation capacity by 2021. While the hydropower sector has served Bhutan well, it has resulted in an increase in the current account deficits, reliance on donor financing and accumulation of public debt. Furthermore, hydropower projects have been unable to boost demand on labor. While, the overall unemployment rate stood at 2.5 percent, the youth unemployment rate stood at nearly 11 percent. Also, managing hydropower revenues will be critical for macroeconomic stability and long-term development. Under these circumstances, achieving sustainable and inclusive growth requires improving fiscal management and a transition to the private-sector led employment opportunities.

II. Proposed Objective(s)

This operation supports reforms to safeguard fiscal sustainability and strengthen private sector's ability to generate employment opportunities. These reforms substantiate the government's 11th Five-Year Plan (FYP) for 2013-18 as well as the policy directions in the 12th FYP for 2018-23 by helping the

authorities design fiscal consolidation measures that will not only help mobilize non-hydro revenues, but also help create a more dynamic private sector. It also strengthens the corporate governance of state-owned enterprises and creates a level playing field between public and private sectors.

Preliminary Description

Fiscal vulnerabilities remain. While GDP growth has been strong, Bhutan faces unique challenges. On the fiscal side, tax collection relative to GDP is declining and domestic revenues is generally met by revenues from hydropower projects. The potential revenues from hydropower projects have made it attractive to increase public expenditures. However, expansionary fiscal policy without sustaining domestic revenue mobilization will risk fiscal sustainability. The fiscal management pillar, therefore, aims to support the government's measures to improve domestic revenue mobilization efforts as well as help design a stabilization fund to manage hydropower revenues.

Employment opportunities remain concentrated within the public sector. Unequal level-playing field between the public and private sectors such as pension coverage has discouraged the development of the private sector. As a result, a large portion of Bhutanese prefer to wait for public job opportunities which further erodes the talent pool for the private sector. This pillar also aims to reduce the disparity between public and private sector by supporting the enhancement of pension coverage and reducing the skills mismatch. Also, this pillar supports key sectors such as tourism, agriculture and ICT to create sustainable employment opportunities especially for the youth.

The proposed operation is fully consistent with the Country Partnership Strategy (CPS) for FY2015-19 and the Performance and Learning Review in June 2017. It supports the government's reform efforts to consolidate fiscal management as well as strengthen its regulatory framework in public finance management areas. By supporting macro and fiscal stability as well as the labor sector opportunities, the operation addresses critical elements for sustained shared prosperity. Without such reforms, the adjustment could be much more abrupt and harmful for the bottom 40 percent of the population. The IMF provides a set of technical assistance and surveillance under a two-year Article IV cycle. The World Bank also has a set of technical assistance on PFM (including domestic revenue mobilization), pensions, stabilization fund and social protection as part of the overall country engagement that will complement this operation.

III. Poverty and Social Impacts and Environment Aspects

As per a preliminary assessment, this operation is expected to have positive impacts on poverty and social and gender, and no significant adverse effects on the environment impacts. The two pillars are expected to improve overall macroeconomic stability, enhance growth and create more employment opportunities especially for the youth and women, thereby ensuring a potentially high social and gender effects. While measures to promote fiscal sustainability and private sector employment are expected to be environmentally neutral, the operation will discuss, as part of the environmental analysis, whether the prior actions are likely to have any significant effects on environment, forests and natural resources. In that context, the operation will discuss the Bhutan's systems for reducing adverse and enhancing positive effects associated with the specific policies supported. If there are significant gaps in the analysis or shortcomings in the systems, the operation will describe how such gaps or shortcomings will be addressed. A poverty and social impact analysis (PISA) will be also carried out during the preparation phase of the operation.

Tentative financing: US\$30 million in equivalent USD, IDA Development Policy Credit.

IV. Contact point

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