

Public Disclosure Authorized

CONFORMED COPY

GRANT NUMBER H306-BHU

Financing Agreement

(Second Development Policy Grant)

between

KINGDOM OF BHUTAN

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated June 22, 2007

Public Disclosure Authorized

FINANCING AGREEMENT

AGREEMENT dated June 22, 2007, entered into between KINGDOM OF BHUTAN (“Recipient”) and INTERNATIONAL DEVELOPMENT ASSOCIATION (“Association”) for the purpose of providing financing in support of the Program (as defined in the Appendix to this Agreement). The Association has decided to provide this financing on the basis, *inter-alia*, of: (a) the actions which the Recipient has already taken under the Program and which are described in Section I of Schedule 1 to this Agreement; and (b) the Recipient’s maintenance of an appropriate macro-economic policy framework. The Recipient and the Association therefore hereby agree as follows:

ARTICLE I - GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in the Financing Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II - FINANCING

- 2.01. The Association agrees to extend to the Recipient, on the terms and conditions set forth or referred to in this Agreement, a grant in an amount equivalent to eight million Special Drawing Rights (SDR 8,000,000) (“Grant”) to assist in financing the Program.
- 2.02. The Recipient may withdraw the proceeds of the Financing in support of the Program in accordance with Section II of Schedule 1 to this Agreement.

ARTICLE III - PROGRAM

- 3.01. The Recipient declares its commitment to the Program and its implementation. To this end:
 - (a) the Recipient and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program;

- (b) prior to each such exchange of views, the Recipient shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request; and
- (c) without limitation upon the provisions of paragraphs (a) and (b) of this Section, the Recipient shall exchange views with the Association on any proposed action to be taken after the disbursement of the Financing which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program including any action specified in Section I of Schedule 1 to this Agreement.

ARTICLE IV - REMEDIES OF THE ASSOCIATION

- 4.01. The Additional Event of Suspension is that a situation has arisen which shall make it improbable that the Program, or a significant part of the Program, will be carried out.
- 4.02. The Additional Events of Acceleration is that event specified in Section 4.01 of this Agreement occurs and is continuing for a period of sixty (60) days after notice of the event has been given by the Association to the Recipient.

ARTICLE V - EFFECTIVENESS

- 5.01. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

ARTICLE VI - REPRESENTATIVE; ADDRESSES

- 6.01. The Recipient's Representative is the Minister of Finance.
- 6.02. The Recipient's Address is:

Ministry of Finance
Tashichhodzong
Thimphu, Kingdom of Bhutan

Cable address:	Telex:	Facsimile:
Ministry of Finance Thimphu, Bhutan	890-201	323154

6.03. The Association's Address is:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423(MCI) or 64145(MCI)	202-477-6391

AGREED at District of Columbia, United States of America, as of the day and year first above written.

KINGDOM OF BHUTAN

By /s/ Daw Penjo

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Praful C. Patel

Authorized Representative

SCHEDULE 1

Program Actions; Availability of Financing Proceeds

Section I. Actions Taken Under the Program

The actions taken by the Recipient under the Program include the following:

1. The Recipient has submitted the MTFP to the Council of Ministers, as part of the annual budget preparation process, said budget to feature entries for expenditure, revenue, deficits and debt developed in accordance with MTFP targets and to involve the implementation of a strengthened debt management system.
2. The Recipient has submitted for audit by its Royal Audit Authority the Recipient's annual financial statement for fiscal year 2005-2006, and has prepared an in-year budget report for the six month period ending December 31, 2006.
3. The Recipient has issued a revised procurement manual regulating procurement undertaken by the Recipient's agencies.
4. The Recipient has enacted labor and employment legislation, whose content has been found satisfactory by the Association.
5. The Recipient has taken all regulatory and other actions to simplify the business registration process for all businesses and small enterprises, including the number of procedures, time taken and costs involved.
6. The Recipient has established twenty (20) new community primary schools in remote or underserved areas to increase enrollment at the primary level.
7. The Recipient has commenced the process of reforming its education management information system by piloting the system through workshops for central and Dzongkhag-level users.
8. The Recipient has piloted, at the basic health unit level, new initiatives to increase community awareness and health promotion interventions regarding antenatal and delivery care, and to strengthen community participation in this area, in two Dzongkhags (Trongsa and Mongar).

Section II. Availability of Financing Proceeds

- A. **General.** The Recipient may withdraw the proceeds of the Financing in accordance with the provisions of this Section and such additional instructions as the Association may specify by notice to the Recipient.
- B. **Allocation of Financing Amounts.** The Financing shall be withdrawn in a single tranche.
- C. **Deposits of Financing Amounts.** Except as the Association may otherwise agree:
 - 1. all withdrawals from the Financing Account shall be deposited by the Association into an account designated by the Recipient and acceptable to the Association; and
 - 2. the Recipient shall ensure that upon each deposit of an amount of the Financing into this account, an equivalent amount is accounted for in the Recipient's budget management system, in a manner acceptable to the Association.
- D. **Excluded Expenditures.** The Recipient undertakes that the proceeds of the Financing shall not be used to finance Excluded Expenditures. If the Association determines at any time that an amount of the Financing was used to make a payment for an Excluded Expenditure, the Recipient shall, promptly upon notice from the Association, refund an amount equal to the amount of such payment to the Association. Amounts refunded to the Association upon such request shall be cancelled.
- E. **Closing Date.** The Closing Date is June 30, 2008.

APPENDIX

Section I. Definitions

1. "Council of Ministers" means the Recipient's council of ministers, or any successor thereto.
2. "Dzongkhag" means a sub-national administrative District area within the Kingdom of Bhutan.
3. "Excluded Expenditure" means any expenditure:
 - (a) for goods or services supplied under a contract which any national or international financing institution or agency other than the Association or the Bank has financed or agreed to finance, or which the Association or the Bank has financed or agreed to finance under another Financing, credit, grant or loan;
 - (b) for goods included in the following groups or sub-groups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Association by notice to the Recipient:

Group	Sub-group	Description of Item
112		Alcoholic beverages
121		Tobacco, un-manufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, non-monetary (excluding gold ores and concentrates)

- (c) for goods intended for a military or paramilitary purpose or for luxury consumption;
 - (d) for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Recipient or international agreements to which the Recipient is a party;
 - (e) on account of any payment prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
 - (f) under a contract with respect to which the Association determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the Recipient or other recipient of the Financing proceeds during the procurement or execution of such contract, without the Recipient (or other such recipient) having taken timely and appropriate action satisfactory to the Association to remedy the situation.
4. “General Conditions” means the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005 (as amended through October 15, 2006), with the modifications set forth in Section II of this Appendix.
5. “Medium Term Fiscal Framework” or “MTFF” means the Recipient’s Medium Term Fiscal Framework designed to strengthen, *inter-alia*, fiscal policy, including building closer links between sectoral goals and budgets, and fostering transparency, to ensure a sound macroeconomic framework.
6. “National Assembly” means the Recipient’s National Assembly or any successor thereto.
7. “Program” means the program of actions, objectives and policies designed to promote growth and achieve sustainable reductions in poverty and set forth or referred to in the letter dated April 17, 2007, from the Recipient to the Association declaring the Recipient’s commitment to the execution of the Program, and requesting assistance from the Association in support of the Program during its execution.

Section II. Modifications to the General Conditions

The modifications to the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005 (as amended through October 15, 2006), are as follows:

1. The last sentence of paragraph (a) of Section 2.03 (relating to Applications for Withdrawal) is deleted in its entirety.
2. Sections 2.04 (*Designated Accounts*) and 2.05 (*Eligible Expenditures*) are deleted in their entirety, and the remaining Sections in Article II are renumbered accordingly.
3. Sections 4.01 (*Project Execution Generally*), and 4.09 (*Financial Management; Financial Statements; Audits*) are deleted in their entirety, and the remaining Sections in Article IV are renumbered accordingly.
4. Paragraph (a) of Section 4.05 (renumbered as such pursuant to paragraph 3 above and relating to *Use of Goods, Works and Services*) is deleted in its entirety.
5. Paragraph (c) of Section 4.06 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

“Section 4.06. *Plans; Documents; Records*

(c) The Recipient shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Financing until two years after the Closing Date. The Recipient shall enable the Association’s representatives to examine such records.”

6. Section 4.07 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

Section 4.07. *Program Monitoring and Evaluation*

(c) The Recipient shall prepare, or cause to be prepared, and furnish to the Association not later than six (6) months after the Closing Date, a report of such scope and in such detail as the Association shall reasonably request, on the execution of the Program, the performance by the Recipient and the Association of their respective obligations under the Legal Agreements and the accomplishment of the purposes of the Financing.

7. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:
 - (a) The definition of the term “Eligible Expenditure” is modified to read as follows:

“‘Eligible Expenditure’ means any use to which the Financing is put in support of the Program, other than to finance expenditures excluded pursuant to the Financing Agreement.”

- (b) The term “Financial Statements” and its definition as set forth in the Appendix are deleted in their entirety.
- (c) The term “Project” is modified to read “Program” and its definition is modified to read as follows:

“‘Program’ means the program referred to in the Financing Agreement in support of which the Financing is made.” All references to “Project” throughout these General Conditions are deemed to be references to “Program”.

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