



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 18-May-2022 | Report No: PIDA34209



BASIC INFORMATION

A. Basic Project Data

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|-----------------------|----------------------|--|------------------------------|
| Country | Project ID | Project Name | Parent Project ID (if any) |
| Bhutan | P177712 | Green and Resilient Growth DPC-1 (P177712) | |
| Region | Estimated Board Date | Practice Area (Lead) | Financing Instrument |
| SOUTH ASIA | 21-Jun-2022 | Macroeconomics, Trade and Investment | Development Policy Financing |
| Borrower(s) | Implementing Agency | | |
| The Kingdom of Bhutan | Ministry of Finance | | |

Proposed Development Objective(s)

The operation aims to (i) strengthen resilient and private sector-led growth through fiscal sustainability and enhanced access to finance and markets, and (ii) foster green growth focused on renewable natural resources.

Financing (in US\$, Millions)

SUMMARY

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|------------------------|-------|
| Total Financing | 52.50 |
|------------------------|-------|

DETAILS

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|---|-------|
| Total World Bank Group Financing | 52.50 |
| World Bank Lending | 52.50 |

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Rapid economic growth has contributed to substantial poverty reduction over the last two decades, but the COVID-19 pandemic reversed some progress. Bhutan’s economy grew at an average annual rate of 7.2 percent between 2000 and 2019 and its per capita income increased threefold in PPP terms over the same period. As a result, extreme poverty based on the \$1.90/day poverty line was almost eliminated, decreasing from 18 percent in 2003 to 1.5 percent in 2017. Similarly, poverty measured by the \$3.20/day poverty line decreased by two-thirds, from 45 percent in 2003 to 12 percent in 2017. The COVID-19 pandemic caused major disruptions to economic activity and reversed some progress. Economic growth



contracted by 2.4 and 3.7 percent in FY19/20 and FY20/21, respectively. While the state-led hydropower sector cushioned the impact of the crisis on economic growth and fiscal accounts, the non-hydro industry and services sectors were adversely affected by trade-related disruptions, shortages of foreign labor, and the standstill of tourism. This has had a direct impact on worker earnings and contributed to an increase in the estimated \$3.20 poverty rate from 11.0 percent in 2019 to 12.6 percent in 2021.

The proposed operation—the first in a programmatic series of two development policy credits (DPCs)—supports the Royal Government of Bhutan’s (RGoB) efforts for resilient and green development. A more resilient economy with a green and diverse production base can support the COVID-19 recovery and future development, which is in line with the WBG’s approach to Green, Resilient and Inclusive Development (GRID).¹ The operation builds on the reform program supported under the “Strengthening Fiscal Management and Private Sector Employment Opportunities” DPC series completed in FY20, and the “COVID-19 Crisis Response” DPC completed in FY21.

Relationship to CPF

This DPC series is fully consistent with the FY21-24 Country Partnership Framework (CPF).² Policy actions included in this operation are directly related to the first two CPF development challenges, a lack of job opportunities and macroeconomic vulnerability. The CPF prioritizes macro-fiscal stability through reforms that address financial sector vulnerabilities that heightened amid the COVID-19 pandemic and that increase transparency in fiscal and debt management. It also identifies better access to finance and digital solutions as priorities to boost private sector development. The CPF further envisions a shift from conservation to sustainable natural resource management in general and focuses especially on sustainable forest management.

C. Proposed Development Objective(s)

The operation aims to (i) strengthen resilient and private sector-led growth through fiscal sustainability and enhanced access to finance and markets, and (ii) foster green growth focused on renewable natural resources.

Key Results

Results intended to strengthen resilient and private sector-led growth aim at: (i) increasing the number of non-performing loans (NPLs) resolved through out-of-court settlement; (ii) improving access to external commercial borrowing for the private sector; (iii) improving the reporting and transparency of fiscal risks from state-owned enterprises (SOEs) and public debt; (iv) increasing the number of e-commerce business licenses; and (v) lowering import tariffs.

To foster green growth focused on renewable natural resources, this DPC aims at three key results: (i) increasing the production of organic produce; (ii) increasing the number of business licenses for sustainable forest-based industries; and (iii) generating revenues through the sale of emission offsets (carbon credits) from hydropower and other renewable natural resources.

D. Project Description

The proposed operation aims to achieve its policy objectives through two pillars, the first of which aims at strengthening resilient and private sector-led growth through fiscal sustainability and enhanced access to finance and markets. The operation will support the resolution of NPLs in the financial sector by simplifying out-of-court settlements, which is expected to support credit growth to the private sector and to strengthen the resilience of the financial system. The annual

¹ “From COVID-19 Crisis Response to Resilient Recovery - Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID)”, prepared by the World Bank Group for the virtual April 9, 2021 Development Committee Meeting

² Report No. 154927-BT, discussed by the Board on January 14, 2021



publication of the Debt Sustainability Analysis (DSA) improves the monitoring of public debt and fiscal risks from SOEs. Pillar 1 also supports the e-commerce policy, which will foster the digital economy and especially benefit women. Finally, the program under pillar 1 supports the new Customs Duty Act, which will reduce trade costs.

The second pillar of the operation aims at fostering green growth by leveraging Bhutan’s natural renewable resources.

The Forest and Nature Conservation (FNC) Bill is expected to promote the sustainable management of forests, while continuing to ensure conservation of renewable natural resources. This is expected to create green and inclusive economic opportunities in remote areas, where many of the poor and vulnerable live.

The proposed operation supports the government’s reform agenda. Actions supported in this operation contribute to the objectives of the 12th Five-Year Plan (FYP), and the government’s focus on economic recovery and growth following the COVID-19 pandemic. Measures under pillars 1 and 2 are aligned with the 12th FYP’s objectives of building a *sustainable, just, and harmonious society*. Reforms under pillar 1 ensure fiscal and financial sector stability through enhanced fiscal risk assessment, SOE oversight, and simplified NPL resolution. Pillar 1 also supports better access to finance and digital solutions as priorities to boost private sector development. These policy actions are expected to support economic diversification, supporting the objectives of two flagship programs (Digitalizing Bhutan, Increasing Economic Diversification). Measures under pillar 2 promote the sustainable and productive use of forests to expand economic opportunities and jobs, while preserving the environment.

E. Implementation

Institutional and Implementation Arrangements

The Ministry of Finance (MoF) leads the effort in coordinating the overall implementation of the DPC. The Ministry has experience and is conversant with World Bank policies and procedures through lending and technical assistance operations. Given the history of budget lending operations in Bhutan, some institutional capacity has been built up on data requirements and overall monitoring arrangements. Bhutan is one of the first countries in the Asia and Pacific Region to implement the recommendations of the Enhanced General Data Dissemination System (e-GDDS). The National Summary Data Page utilizing the Statistical Data and Meta Data Exchange is available on the National Statistics Bureau’s website. In addition, data is generally available through the MoF and the central bank’s website. The World Bank team will continue to provide support to the government in monitoring the reform progress and results.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The overall poverty and social impact of the DPC is likely to be moderately positive. Most of the policy actions are expected to have positive indirect effects for the poor. The policy supporting the sustainable and productive use of forests is expected to support rural livelihoods and create new job opportunities, which will likely benefit the poor and vulnerable, a sizeable number of whom are still engaged in subsistence agriculture and community forestry. The e-commerce policy can (i) pave the way for the creation of new economic opportunities for small scale entrepreneurs, including women; (ii) improve digital access and skills among the underserved; and (iii) strengthen the institutional framework for the adoption of strong data protection, cyber security, and consumer protection measures to safeguard citizens, especially the less digital savvy ones. The Customs Duty Act is likely to be moderately pro-poor, as it reduces the cost of the consumption basket, including for the poor. It can also reduce trade and production costs for Bhutanese firms and make them more productive, which can have direct benefits to workers in the tradeable sectors and spillover benefits for workers in other sectors of the economy.



Environmental, Forests, and Other Natural Resource Aspects

The operation is not expected to have significant negative effects on the environment, forests, and other natural resources. The FNC Bill, which aims at promoting sustainable use of forests, is expected to generate positive environmental effects. More specifically, the bill will support Bhutan’s objective to remain a global champion for environmental conservation, while developing a modernized and resource-efficient forestry sector to support growth and job creation through sustainable forest management. Investing in sustainable forest management will enhance resilience to climate change through erosion and flood control and increase carbon sequestration potential, thereby supporting the country’s commitment to remain carbon neutral. More investments in wood-substitution technology will allow Bhutan to replace greenhouse gas emission-intense materials like steel and cement with wood. DPC-2 will support the preparation of the FNC Rules, which will undergo stakeholder consultations and outline standards and procedures for clearance, operation, monitoring and oversight of different types of sustainable forest management activities. The e-commerce policy is expected to generate mostly positive environmental effects, as on-line shopping tends to result in less greenhouse gas emissions and PM2.5 emissions than offline shopping, reduced land use for physical retail, and reduced paper waste. The remaining reforms are expected to have neutral environmental impacts.

G. Risks and Mitigation

The overall risk rating for the current operation is moderate. While most risks are considered moderate, some categories have substantial risks. Stakeholder risks are substantial as some reforms may face resistance from interest groups. Reducing restrictions on external commercial borrowing could face resistance from regulators focused on financial stability and some domestic lenders benefitting from the current restrictions. Greater SOE oversight could be opposed by SOEs currently benefiting from lax oversight and those rejecting a need for SOE reform. The success of the FNC Bill will crucially depend on the details of the related rules, which different stakeholder may try to influence in their favor. These risks are partly mitigated by extensive public consultations, but residual risks remain. Technical design risks and institutional capacity risks are also substantial, given that institutional capacity gaps exist. Limited technical capacity further deteriorated amid the COVID-19 pandemic and related containment measures. A complex organizational structure poses additional risks to the achievement of the Proposed Development Objective (PDO). The risks to the implementation of the policy matrix are mitigated by strong government ownership of the proposed reforms and continued technical assistance from the World Bank and other development partners, but residual risks remain for the effectiveness of reform progress in the long run.

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APPROVAL

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Approved By

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| Country Director: | Mercy Miyang Tembon | 18-May-2022 |
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