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**ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG**



DMEA/WB-DPC/2018/ 106

February 27, 2018

Dr. Jim Yong Kim
President
The World Bank Group
Washington DC 20433
USA

Dear Dr. Kim,

1. This letter of Development Policy lays out the key elements of the Royal Government of Bhutan's (RGoB) proposed Policy and Institutional Reform Program over the next three years. The RGoB requests the assistance of the World Bank Group in the form of the Development Policy Financing (DPF) instrument for US\$ 30 million. This financing will be used to support the reform areas articulated in the 11th Five Year Plan as well as the first two years of the 12th Five Year Plan. The main objective of the 11th Five Year Plan is green socio-economic development and self-reliance. The assistance from the World Bank Group is needed to especially support the RGoB's efforts to improve fiscal sustainability and to strengthen private sector employment opportunities in the country.
2. The Royal Government of Bhutan would like to thank the International Development Association for providing extensive support through the DPF instrument in the past. Starting with a Development Policy Grant in FY 2006, Bhutan has benefited from the use of the DPF instrument in FY 2007, FY 2009, FY 2012 and FY 2016. All these operations have helped to deepen Policy and Institutional Reforms in the country and were deeply embedded in our respective Five-Year Plans as well. As a result, Bhutan made significant progress to achieve the MDGs and reduce poverty from 12 percent in 2012 to 8 percent in 2017. The Royal Government of Bhutan also remains committed to realize its long-term Vision 2020 social goals as well as the medium term Sustainable Development Goals (SDGs) by 2030.
3. The Royal Government of Bhutan requests continuing World Bank support through the proposed programmatic Development Policy Credit (DPC) to support institutional strengthening in some key areas. Building on the momentum and the lessons learned from the past DPF operations, the RGoB believes that the instrument is highly useful in facilitating development in Bhutan and to enable the World Bank Group in achieving its own twin goals of reducing poverty and boosting shared prosperity across its member states. The RGoB requests selective support for the goals and strategies under the 11th Five Year Plan and is committed to implement the institutional and policy reforms described in the policy and results matrix. The following two broad thematic areas are being addressed in this DPC series: (A) Improving Fiscal Sustainability and (B) Strengthening Private Sector Employment Opportunities.



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(A) Improving Fiscal Sustainability

4. Improving fiscal sustainability is one of the overarching objectives of the 11th Five Year Plan and is expected to remain there as part of the 12th Year Plan as well. Despite sustained economic growth, Bhutan was exposed to macroeconomic vulnerabilities during the last several years. In order to address these vulnerabilities and to smoothen consumption, the RGoB will look to establish a Stabilization Fund. Furthermore, to improve fiscal responsibility and supplement efforts to increase self-reliance the RGoB also will take steps to introduce new tax measures including the establishment of a new Goods and Services Tax (GST) under this Program.
5. The Royal Government of Bhutan also believes that improved Public Financial Management (PFM) systems will help to improve the quality of public spending in the country. With that in mind, the RGoB has recently approved its new PFM Reform Strategy. To complement the objectives of the new PFM Reform Strategy, the RGoB through this operation will also look to improve public procurement systems and introduce gender and climate change budgeting.

(B) Strengthening Private Sector Employment Opportunities

6. The Royal Government of Bhutan continues to play a key role in the economic development of the country as the private sector still remains relatively small and underdeveloped. In order to boost the role of the private sector, the 11th Five Year Plan placed great emphasis on economic diversification, skill development, access to finance and sustainable and inclusive development. All these areas form part of the Green Accelerated Economic Development section of the 11th Five Year Plan which greatly emphasis on the development of the non-hydropower sectors and fostering growth of a dynamic private sector that catalyzes a transition to a green economy. As you might be aware that as the only carbon negative country in the World, Bhutan incorporates climate change initiatives within our development planning framework.
7. Through this operation, the Royal Government of Bhutan will provide a direct support to reform its thrust sectors of Agriculture, Tourism and Cottage and Small Industries. The RGoB has approved new guidelines for Business Incubation Centers for CSIs and approved a new Renewable Natural Resources (RNR) Marketing Policy for agricultural products. The Incubation Centers will provide aspiring entrepreneurs with necessary training in business operations (including financing, sales and marketing) while the RNR Marketing Policy will provide incentives to farmers to ensure commercialization of crops, enhance fair pricing of agriculture products and improve market access to increase Bhutanese's agriculture exports.
8. The Royal Government of Bhutan will also take steps to improve bottlenecks such as access to finance and use the DPC operation to improve skills development in the country. Implementation of the proposed legal reforms to improve financial infrastructure (Credit



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Information Bureau, collateral registry, and e-money) and strengthen the legal rights of creditors and borrowers will go a long way in addressing the access to finance constraints.

9. As highlighted above, the Royal Government of Bhutan strongly believes in an economic growth trajectory that is sustainable and inclusive. While Bhutan's policy planning process naturally incorporates climate change impact, the Economic Development Policy (2016) emphasizes that energy efficiency and conservation measures are institutionalized and promoted. Through this operation, we will support efforts to implement a new energy efficiency program.

Conclusion

10. The Royal Government of Bhutan remains highly committed to our reform progress supported by the proposed programmatic DPC series. We would like to express our appreciation for the support and the assistance extended by the World Bank Group to Bhutan's socio-economic development. We look forward to continued support and fruitful collaboration in the years to come.

Yours sincerely,

Namgay Dorji
(Finance Minister)