

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

September 14, 2016  
Report No.: 110921

<b>Operation Name</b>	Development Policy Credit 2: Fiscal Sustainability & Investment Climate
<b>Region</b>	SOUTH ASIA
<b>Country</b>	Bhutan
<b>Sector</b>	General industry and trade sector (40%); General finance sector (30%); General public administration sector (30%)
<b>Operation ID</b>	P157469
<b>Lending Instrument</b>	Development Policy Lending
<b>Borrower(s)</b>	MINISTRY OF FINANCE, Royal Government of Bhutan
<b>Implementing Agency</b>	Ministry of Finance Bhutan
<b>Date PID Prepared</b>	September 14, 2016
<b>Estimated Date of Appraisal</b>	October 17, 2016
<b>Estimated Date of Board Approval</b>	December 20, 2016
<b>Corporate Review Decision</b>	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

**I. Key development issues and rationale for Bank involvement**

Bhutan's peaceful transition from a monarchy to a democratic constitutional monarchy in 2008 has accelerated further poverty reduction, shared prosperity and improvement in service delivery. The economy has grown on average 7.6 percent in the past decade, 16<sup>th</sup> highest among 135 countries. Gross Domestic Product per capita has almost doubled to US\$2,500 in 2014. Building on significant progress in achieving the Millennium Development Goals, Bhutan has been selected as one of the early mover countries in the Asia Pacific region for Sustainable Development Goals (SDGs) localization by the United Nations Development Program. The country's development approach, the Gross National Happiness principles, is anchored in the Constitution at the top level. The medium-term strategies have been implemented to realize GNH. The latest medium-term strategy, the 11<sup>th</sup> five-year plan (FYP), has institutionalized regular monitoring mechanism such as the introduction of the GNH survey. By 2012, Bhutan mostly eliminated extreme poverty to 2 percent using the international poverty line of US\$1.90 a day (PPP). This is substantially lower than the regional average of 19 percent. Per capita consumption among the bottom 40 percent of the population has grown almost equal as the rest. Even using a higher international poverty line of US\$3.10 a day, the poverty rate was halved from 29 percent in 2007 to 14 percent in 2012.

Past economic developments have been driven by the public sector (including the developments of hydropower projects). While the public sector driven economic development has been successful, it has resulted in the increase in the current account

deficits, reliance on donor financing and accumulation of public debt. Also, the absorption capacity of the economy to the new entrants to the labor market has been limited. The current account deficits exceeded 25 percent of GDP and public sector debt reached nearly 100 percent of GDP. On the labor market, while the overall unemployment rate stood at 2.5 percent, the youth unemployment rate kept increasing to above 10 percent. Under these circumstances, achieving sustainable and inclusive high growth requires maintaining macroeconomic stability and a transition to the private-sector led economic development.

## **II. Proposed Objective(s)**

The Program Development Objective is to promote fiscal discipline, improve access to finance for enterprises, and improve the climate for business entry and investment in Bhutan.

## **III. Preliminary Description**

The proposed International Development Association (IDA) development policy credit (DPC) of US\$20 million is the second (DPC2) of a programmatic series of two aiming to promote fiscal discipline, improve access to finance for enterprises, and improve the climate for business entry and investment in Bhutan. The series focuses on three pillars: (i) strengthen fiscal discipline and self-reliance; (ii) increase access to finance; (iii) improve the business climate and increasing domestic/foreign investment. By contributing to addressing Bhutan's two key challenges, this DPC series is designed to support Bhutan's Eleventh Five-Year Plan (2013–2018) (11th FYP) objective of green socio-economic development and self-reliance.

Building on the completed prior actions under the first Operation (DPC1), this Operation proposes to include eight prior actions. Under the first pillar, cabinet approval on the public debt policy and the Ministry of Finance approval on tax rationalization measures are proposed. Bhutan's large fiscal gap funded by donor resources calls for fiscal consolidation and prudent debt policy. Enhancing tax collection is an integral component of achieving fiscal self-reliance. Under the second pillar, cabinet approval of the new insolvency bill, improving functions of the Credit Information Bureau, and cabinet approval of the Financial Sector Development Action Plan are proposed. Bhutan's firms and especially its SMEs have limited access to financial services. Both 2009 and 2015 Enterprise Surveys show that the top constraint that firms face is access to finance. These proposed prior actions are key to increasing access to finance. Under the third pillar, improving the electronic property and land registration system, introducing a single window for online business registration and cabinet approval of the Public-Private Partnership (PPP) policy and MoF's approval on PPP rules and regulations are proposed. The government recognizes that a credible and predictable policy environment that minimizes the cost of doing business, expedites business start-ups, and facilitates FDI is vital to achieving the objectives envisaged in the 11<sup>th</sup> FYP. These prior actions are key to improve business environment.

## **IV. Poverty and Social Impacts and Environment Aspects**

### **Poverty and Social Impacts**

**The policies supported by this DPC are expected to have a positive poverty and**

**social impact over the medium- and long-term.** The reforms supported under this operation contribute to achieving the World Bank’s twin goals of poverty reduction and shared prosperity by: (i) improving the fiscal sustainability and macroeconomic stability, conditions necessary for sustainable growth and thus for poverty reduction and shared prosperity; and (ii) improving access to finance and the investment climate for the private sector, to contribute to growth diversification and job creation (particularly for the poor and disadvantaged groups). By enhancing growth and providing jobs, these reforms contribute to reducing poverty and further expanding shared prosperity. The reforms are expected to have neutral impact on Bhutan’s good record of gender equality.

## **Environment Aspects**

**The proposed DPC series will not produce any adverse environmental impacts.** Measures to promote fiscal sustainability and financial-sector development are expected to be environmentally neutral. None of the policies supported by the proposed DPC series is likely to cause significant effects on the country’s environment, forests, or other natural resources. In addition, Bhutan has systems in place for reducing any eventual adverse effect, as described in paragraph of OP 8.60. The RGoB’s capability to manage any environmental impacts arising from private-sector development is good, as reflected in the country’s consistently high Country Policy and Institutional Assessment (CPIA) score for environment. Bhutan has adequate legislative cover, policy guidelines, and institutional mechanisms in place to manage any potential adverse effects on the environment, forests, and other natural resources. Bhutan has accorded a high priority to environmental conservation and sustainable development. Bhutan’s constitution, the 20-year perspective plan (Bhutan 2020), the Eleventh Five-Year Plan, and the National Environment Strategy, all enshrine the concept of sustainable development. Projects and developmental activities are not permitted in protected areas. All development proposals are subject to environmental assessment as required by the Environmental Assessment Act (2000) and Regulation for the Environmental Clearance of Projects and Regulation on Strategic Environmental Assessment (2002). The government has made progress in strengthening environmental considerations by enacting the National Environment Protection Act of Bhutan (NEPA 2007), an umbrella environmental act. Building on experience, Bhutan is also in the process of revising the Environmental Act and Regulations, the Application for Environmental Clearance Guidelines, and also the Environmental Codes of Practices. Bhutan also plans to further strengthen the capacity of its main regulatory agency, the National Environmental Commission, for its clearance and compliance functions.

## **V. Tentative financing**

Source:	(\$m.)
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	20.00
Borrower/Recipient	
IBRD	
Others (specify)	
	Total

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