



Bhutan: Country Snapshots

March 2014

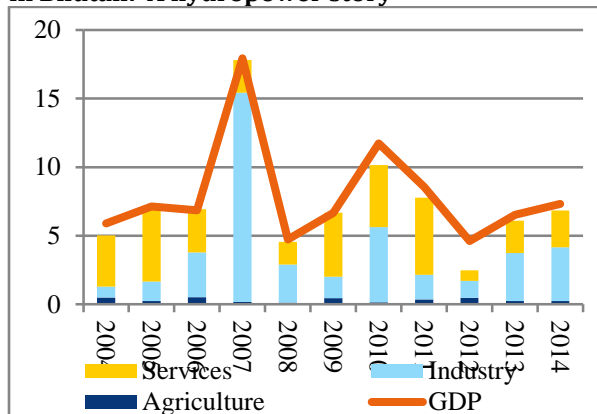
Recent Economic Developments



Growth Performance

Growth slowed to 4.6 percent in 2012 as steps to curb a potential credit bubble combined with sluggish growth in agriculture and a delay in the construction of the Punasantgchhu I hydropower project to dampen activity, resulting in the slowest pace of economic expansion since 2008. However, growth is expected to recover to 6.5 percent in 2013, supported by hydropower projects under construction, good rainfall which will lead to more electricity generation, and better performance by agriculture. The impact of energy tariff increase on ferro-alloys and other energy intensive industries ought not be large, given that energy prices remain very competitive in Bhutan.

Figure 1: Ups and downs of economic growth in Bhutan: A hydropower story



Source: National Statistical Bureau and Macroeconomic Framework Coordination Committee (MFCC)

The 2014 outlook is positive but macroeconomic pressures on domestic demand will have to be managed. We estimate growth will advance to 7.3 percent, supported by a combination of favorable factors. These include the on-going construction of four hydropower projects; the

commissioning of the Dagacchu project by mid-2014; Dungsam Cement coming on line; and an expected end to bans on imports and housing credit, which were imposed to prevent economic overheating. In addition, disbursements from India to finance Bhutan's 11th Five Year Plan should lead to higher public capital spending. There are also anticipated benefits from economic stimulus plans; increases in public wages expected in the FY15 budget; and an expansion of tourism through innovative measures to lift the sector. This boost to economic activity comes with the risk of fresh economic overheating and worsening macroeconomic imbalances unless domestic demand is managed carefully. Indeed, it will be important to tighten both monetary and fiscal policy in light of upcoming disbursements from economic stimulus, as well as the proposed increase in the public service wage bill and a proposed relaxation of restrictions over foreign exchange, vehicles imports and housing loans, which could all undermine economic stability. Fiscal tightening with consistent monetary policy measures will be needed to avoid fresh rupee shortages once the restrictions are lifted.

Inflation

With 75 percent of Bhutan's imports coming from India and an exchange rate at par with the Indian rupee, Bhutan's consumer inflation is intimately linked to India's inflation. Food and beverages has the heaviest weighting in Bhutan's consumer price index, at 36.9. With most of such items imported from India, food prices there will continue to have the strongest impact on the overall rate of inflation in Bhutan. Structural drivers of inflation in India, including rising food prices, are expected to persist. India's consumer price inflation averaged a rapid 10.1 percent in 2013 and it is expected that inflationary pressures in India will remain in the near future. Consumer price inflation in Bhutan accelerated to 11.3 percent year-on-year in the third quarter of 2013, up from 7.3 percent in the second quarter. Inflation is expected to be 10 percent for 2013 as a whole

and price pressures will likely remain present in 2014 but then ease slightly, following India.

Fiscal Policy

The government continues to rely heavily on foreign grants to finance its expenditure. Grants finance around 36 percent of total spending, or 10 percent of GDP in fiscal year 2012/13, of which the government of India provides around 70 percent. The budget for 2013/14 projected a decline of nearly nine percent in nominal spending compared with the revised budget for the previous fiscal year. Given the persistent shortage of rupees, the government has tightened the country's expenditure to bring it in line with the available resources. Another reason is the slow start of the budget year following elections over the summer, the change of leadership, and delays in foreign grant disbursements.

Table 1: Government Budget

| <i>As a Percentage of Nominal GDP</i> | 2012/13 | 2013/14 | 2014/15 |
|---------------------------------------|----------------|---------------|--------------|
| | <i>Revised</i> | <i>Budget</i> | <i>Proj.</i> |
| Revenue & Grants | 35.6 | 25.5 | 28.9 |
| Domestic Revenue | 20.0 | 18.9 | 18.6 |
| Tax revenue | 14.6 | 13.4 | 13.7 |
| Non-tax revenue | 5.4 | 5.5 | 4.9 |
| Grants | 15.0 | 6.6 | 10.3 |
| Project-tied Grants | 12.0 | 5.2 | 9.0 |
| Program Grants | 3.0 | 1.4 | 1.3 |
| Other receipts | 0.6 | 0.0 | 0.0 |
| Outlay | 36.6 | 30.0 | 29.6 |
| Total Expenditure | 37.3 | 31.6 | 31.1 |
| Current | 17.7 | 16.2 | 17.6 |
| Capital | 19.7 | 15.4 | 13.4 |
| Net lending (NL) | -0.7 | -1.6 | -1.5 |
| Primary Balance | 1.5 | -2.8 | 0.9 |
| Fiscal Balance | -1.0 | -4.5 | -0.7 |
| Borrowings | 15.9 | 2.3 | 4.8 |
| Repayments | 15.2 | 2.3 | 2.2 |
| Resource Gap (dom. borrowing) | -0.3 | -4.5 | 1.9 |

Source: Government Medium-term Fiscal Framework Committee

The deficit in FY2014/15 should ease to 0.7 percent of GDP, as more revenues will kick in

with commissioning of the Dungsam cement project, the Dagachhu hydro electricity scheme and additional revenues coming from Chhukha's electricity export tariffs.

An upward revision in public compensation is under discussion for FY2014/2015. This could see salaries raised to account for the last three years of inflation, in order to adjust civil servant purchasing power. This would also put upward pressure on domestic demand. Therefore, it will be important to tightening fiscal and monetary policy to counter-balance the increase in public sector purchasing power. Measures could include steps to incentivize saving as opposed to immediate consumption. Taxation, as well as strengthened macro-prudential regulations, are being considered (see section on monetary and financial development).

Public Debt

Bhutan's public and publicly guaranteed (PPG) external debt increased to 85 percent of GDP at end 2012/13, adding 14 percentage points of GDP over the previous year. The rise in the external public debt was, in large part, driven by hydro-sector related external borrowing (52 percent of GDP). Hydropower projects are primarily financed by India with a mix of loans (70 percent) and grants (30 percent). External debt continues to be dominated by Indian rupees, which accounts for 61 percent of total external debt.

Bhutan's risk of external debt distress is moderate.¹ The moderate risk is based on the commercial viability of the hydropower projects, the risk sharing agreement with India for hydropower loans, Bhutan's strong track record of project implementation, rapid growth in energy demand from India, committed donor support, and Bhutan's high level of international reserves. Bhutan's rapid hydropower development is projected to lead

¹ On the basis of the upcoming recent Joint Bank-Fund Sustainability Assessment, 2014

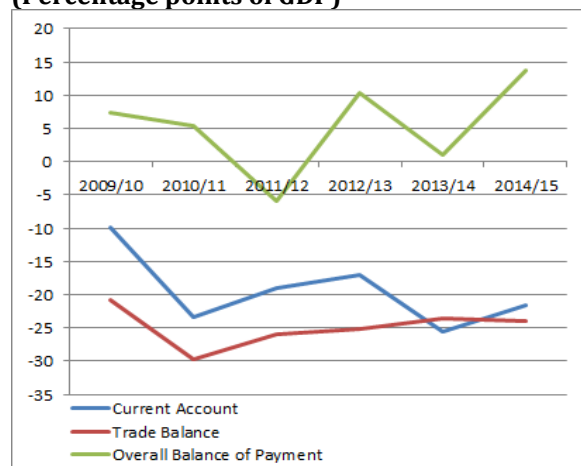
to a substantial buildup of external debt in the medium-term. Bhutan's debt situation is expected to improve over the long run, reflecting significantly higher electricity exports when hydropower projects come on stream.

External sector

Export revenues from sales of electricity are expected to improve in step with good rainfalls in 2013. Since no new hydropower projects have become operational since 2006, the fluctuation in export revenues reflects the vagaries of hydrological flows. The monsoon rains in 2013 have been better than the previous year, which is why data show a 12 percent rise in export revenues from sales of electricity in 2013. Exports of minerals and mineral-based products account for more than half of total exports, with hydropower exports comprising a further 45 percent, and manufactured products a tiny 5 percent. India receives almost 90 percent of Bhutanese electricity production. Continued shortages of power in India will ensure strong demand for electricity from Bhutan

The tourism sector has turned into an important contributor to export revenues in recent years. Tourist arrivals and revenues (from convertible currency-paying tourists) expanded at an average of 15 percent per year in the five years to 2013.

Figure 2: Bhutan's Balance of Payments (Percentage points of GDP)



Source: Royal Monetary Authority

Bhutan runs a large capital account deficit (estimated at about 20 percent in 2013). It is essentially financed by donor resources, of which India contributes the most through loans and grants to finance hydropower development. Even when excluding self-financed hydropower construction imports of goods and services (around a third of total good and services), the current account deficit would stand at 10 percent of GDP, illustrating a significant national dissaving, and the need for the country to borrow to finance consumption imports.

Gross international reserves have built up to 13 months of merchandise exports. International reserves amounted US\$920.8 million by end November 2013, of which 88 percent was in convertible foreign exchange, with the rest in Indian rupees.² There is, however, a continuing mismatch in the composition of Bhutan's reserves and the structure of its international transactions, as the country primarily needs Indian rupees for trade settlement and debt service.

Financial Sector



Picture source: <http://www.bhs.bt/news/wp-content/uploads/2012/12/BoB-LoanOpens.gif>

Bhutan's financial sector compares relatively well with the rest of South Asia, with a private credit ratio of 47.7 percent of GDP in 2012, slightly above the South Asia average of 45.8 percent. The financial sector is dominated by banks and, as would be

² The Constitution requires that foreign exchange reserves should be maintained at 12 months of essential imports.

expected in a country of its size, the stock market size is small with only 20 listed companies.

Significant investments in financial sector infrastructure occurred in the last three years. Among other things, the use of electronic payments in commercial banks is more widespread, a fully functional Credit Information Bureau (public registry bureau) was put in place in 2009, and a central registry for secured transactions was set up in 2013.

Access to financial services has improved, although unequally. For instance, the percentage of adults with a loan account almost tripled between 2007 and 2011 to 14.2 percent. The geographical coverage of bank branches has also risen, but remained at a low average of two branches per 1,000 km² in 2011. Policy efforts to improve financial inclusion saw the launch of a financial literacy campaign across the country in 2011. In addition, with the support of the World Bank, the government in 2012 developed a financial inclusion policy to draw out policy objectives and strategies to increase financial inclusion.

Banking regulation and supervision is being strengthened, starting with the setting up of the new Royal Monetary Authority (RMA) Act in 2010. In addition, the Financial Services Act of 2011 was aimed at better regulating various financial service providers, including non-bank financial institutions (NBFIs).

Bank credit to the private sector grew significantly in recent years. Private sector credit nearly doubled from 2007 to 2012. Factors that contributed to the credit boom include robust economic growth, spillover effects from large hydro projects, expansion of the financial system with the increased number of banks, large salary increases in the public sector, and demographic factors such as urban migration and high demand for housing. Rapid credit growth of the kind seen in Bhutan often leads to deterioration in credit quality, albeit with a lag. So far, there

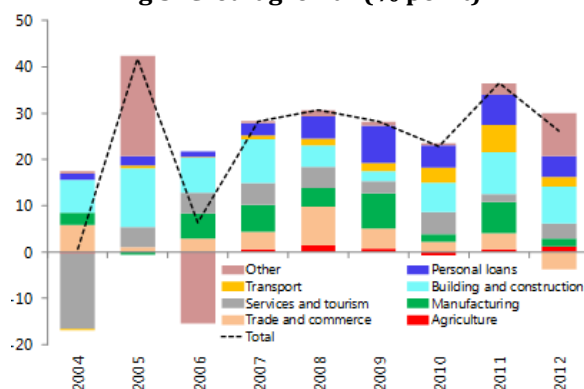
has been a modest rise in non-performing loans (NPLs) with a rate standing at 12.7 percent in September 2013, up from 10.5 percent in September 2012. As of August 2013, the largest sectoral exposure of the banks was in the building and construction sector (27 percent).

Emergency prudential measures have been taken by the central bank, in particular in March 2012, to address the credit boom and ensuing rupee shortage.

Measures include the total ban on new lending in the housing and transport sectors. Though they were initially temporary, these are still in place. Other measures were announced in 2013, including increased risk weightings - effective in December 2013 - that may result in several banks falling below the statutory minimum capital adequacy ratio of 10 percent. In September 2013, banks' capital adequacy ratio remained above the 10 percent threshold, although it had declined from 18.9 to 15.1 percent year-on-year. Nonetheless, the impact of the risk-weighting directive will vary from bank to bank, and risks triggering a credit crunch unless banks receive additional capital.

Policy measures have slowed private-sector credit growth. The liquidity squeeze, coupled with measures taken by the RMA to contain the rupee shortage in March 2012, appear to have slowed total credit growth, which dropped from 33.8 percent (yoy) in January 2012 to seven percent by May 2013. Similarly, private credit growth has slowed down from 30.7 percent to 7.1 percent in June 2013, with a drag on the economy estimated at one percentage point of GDP. Lack of bank liquidity could evolve into a credit crunch, with negative repercussions for the economy.

Fig 3: Credit growth (% point)



Poverty and Statistical Capacity Building



Poverty reduction in Bhutan has been rapid, broad-based and inclusive between 2007 and 2012. Both consumption-based poverty measures and broad-based multi-dimensional poverty indicators show that the percentage of poor was cut by nearly half - from around 23 percent in 2007 to 12-13 percent in 2012. This conclusion is robust to alternative poverty lines. The improvements touched the poorest of the poor, and not only people just under the poverty line. Evidence from focus group discussions reinforce the view that there has been perceptible sense of improvement in living standards in rural Bhutan. Thus Bhutan has almost eliminated extreme poverty (measured as beneath \$1.25 in purchasing power parity terms, per person, per day) within the memory of a single generation.

The primary drivers of such a rapid pace of poverty reduction are the accelerating commercialization of agriculture, rapid development of rural infrastructure (roads, schools, health centers and

electrification) and spillovers from the new construction of massive hydro-electric projects. Helped by the strengthening trade links with neighbors India and Bangladesh (signed in 2006 and 2009), Bhutanese farmers are increasingly specializing in commercial production. The value share of fruits, cardamom and eggs nearly doubled between 2008 and 2012. Rural infrastructure development has been a key area of the 10th Five Year Plan (2008-13), delivering a massive expansion in farm roads to nearly 4,000 km, versus 500 km in 2006. In addition, continuing construction of the Southern East-West Highway (along the India border) has cut travel times and lowered the cost of transporting goods. With an emphasis on rural electrification, 97 percent of the villages are now electrified, with the poor doubling their access. Three new massive hydro-electric power projects (Punatsangachhu I and II, and Mangdechchu) with eight year construction phases were begun between 2008-2010 at a cost of Nu. 187 billion (187 percent of 2012 GDP). Immediate benefits to the local economy from construction activities are sizeable: hiring local contractors for transportation; and a three-fold rise in food and rental spending by foreign construction workers, who number nearly a third of the local population in the project site dzonkhags.

However, poverty reduction is accompanied by some notable vulnerabilities. The chronically poor constituted two-third of all poor in 2012. For every 10 people who moved out of poverty, four fell back. The lack of formal social safety nets and targeting mechanisms for the chronically poor restrains the escape from poverty. Women-led households, although on par with male-led households in terms of poverty incidence, are less upwardly mobile, and have fewer recourses to cope.

Table 2: Poverty Dynamics Based on Synthetic Data for Two Periods, Bhutan 2007-2012 (Joint Probabilities, Percentage)

| First Period & Second Period | Poverty Status |
|------------------------------|----------------|
| Poor, Poor | 8.3 (0.1) |
| Poor, Nonpoor | 10.5 (0.1) |
| Nonpoor, Poor | 4.1 (0.0) |
| Nonpoor, Nonpoor | 77.2 (0.2) |
| N | 6045 |

Note:

1. Predictions are obtained based on data in the second survey round. We use 500 bootstraps in calculating standard errors.
2. All numbers are weighted using population weights.
3. Household heads' ages are restricted to between 25 and 55 for the first survey round and adjusted accordingly with the year difference for the second survey round.

Sustainability of the pace of poverty reduction appears to be good. Rural trade intensification spurred by trade agreements with neighboring countries, and upgrades to road links along the North-South and the Southern East-West highways will continue apace under the 11th Five Year Plan. Ongoing and new hydro-electric projects will continue to stimulate the economy to 2020, and income from projects in production phase will fund the provision of public goods. In the short-term, investment in strengthening irrigation channels, eradication of pests destroying cash crops like oranges and cardamom, effective ways to fend off wild animals (wild boars, monkeys and elephants) that inflict crop losses, plus the introduction of formal social protection mechanisms and crop-insurance could help reduce poverty further and diminish vulnerability.

Bhutan's statistical system is considered fragile, lacking in human resources and a

legal framework, as well as suffering from data weaknesses and poor data coordination. But progress has been made to correct data flaws in select areas, including price data collection, and dissemination using a map portal. Updating the 2008 National Statistical Development Strategy, and the resources it needs for implementation, are relevant areas for engagement with the government.

Private Sector



Bhutan's economy remains dominated by state-owned enterprises (SOEs), with private sector contributing a mere eight percent of national revenue. Advantages include a stable and low-corruption environment, good human development including wide-spread knowledge of English, access to low cost and reliable electricity, preferential access to the large Indian market, and easy access to skilled and unskilled labor from India. Against these advantages, private sector development is limited by the absence of scale economies, uneven access to finance, mismatched labor force skills, and the lack of adequate infrastructure.

To spur private sector development, a number of policies and laws have been formulated. These include the Economic Development Policy (EDP) and amended rules on foreign direct investment (FDI). Forthcoming measures also include an industrial infrastructure development policy to govern economic zones, a public private partnership (PPP) policy, a licensing protocol, and policies on mineral development, renewable energy, and micro, small and medium-sized enterprises (MSME). These are

in addition to a consumer protection bill and an enterprise registration act. The PPP policy and Bhutan's first IT Park (Thimphu Tech Park, the first PPP in Bhutan) were delivered in 2012 with the support of the World Bank.

Private sector participation in infrastructure and social service delivery is important in the context of job creation and bridging the infrastructure gap in Bhutan. The Eleventh Five Year Plan aims to create 82,000 new jobs through the Rapid Investment in Selected Enterprises (RISE) program. Based on experience in other countries, the World Bank Group can assist in finding ways to bridge the skills gap, and in identifying and selecting strategic private sector enterprises for the RISE program.

Doing Business in Bhutan

Despite having improved by five positions in the Doing Business 2014 report compared to last year, Bhutan still lags behind all other South Asian countries except for Afghanistan. Its weakest areas were construction permits (132nd), protecting investors (147th), and trading across borders (172nd), while it performed the best in the area of enforcing contracts (37th). The private sector is small and, while 15 to 24 year-olds represent a fifth of the Bhutanese population, unemployment among the youth is relatively high.

Over the past few years, the government has also taken important steps to improve the investment climate. In the area of business registration, it eliminated two procedures: name approval and location clearance. It created a Land Commission in 2008 to handle cases involving the transfer of property. In 2009, it improved credit information by launching a public credit registry. In August 2013, the Royal Monetary Authority (RMA) opened a collateral registry for moveable collateral.

Preliminary findings of an Investment Climate Reform Memorandum and subsequent action plan suggest several areas where Bhutan can improve its

regulatory environment. These relate to reforms where a lot of work has already taken place and only need a final push to reach conclusion. In particular, the passage of two regulatory reforms through parliament in coming months would help to make it easier to start a business:

- The Enterprise Registration Bill, which will introduce legal forms and registration procedures for partnerships and sole proprietorships. This law will also eliminate the need for an operating license, and will introduce the legal framework for new companies to register online; and
- An amendment to the existing Companies Act (2000), which regulates limited liability companies, will eliminate the requirement for a company seal.

Two other important improvements with a potential medium term big impacts are:

- Modernizing the Company Registry and the Property Registry, which are both still paper based. Furthermore, legislative reviews of secured transactions and insolvency will help uncover bottlenecks related to getting credit.
- Final implementation of the RAMIS system is key for improvement in the areas of taxes and trade.

In addition, many recommendations aimed at the ease of doing business are related to improvements in e-government and e-services, for instance by developing information and communication technology (ICT) infrastructure and internet connectivity.

The “Better Business Summit”, a joint government and private sector initiative, was held in late March in Bhutan to promote investments by providing a platform for dialogue between the public and private sector. To ensure a wide ownership of the medium term reform agenda, the event was used to communicate about the reforms and

to get feedback from the private sector. Political leadership is required to set up an institutional framework to support reforms within the government, and to cut across ministries.

Health



Picture source: <http://futurechallenges.org/wp-content/uploads/2013/01/SDC14012-11.jpg>

Bhutan has sustained investments in health over the last two decades and made remarkable progress. In 2010-11, public health expenditure stood at four percent of GDP and nine percent of government spending, considerably higher than other South Asian countries. The expansion of the network of health facilities now ensures that 90 percent of the population live within a three hour walk of a health facility; there are 25 traditional medicine operations at Basic Health Units (BHUs); and there are at least two functioning ambulances at each district hospital, forming part of a new health helpline and nationwide emergency transport network, accessible by phoning 112.

Access to health services is satisfactory, although peripheral facilities require improvement and service quality needs to be improved. The Constitution (2008) lays out that the state will provide free basic public health services to all citizens. As of now, all health services, barring a handful of dental, cosmetic and other services, including international referrals where needed, are provided free by the government. Nevertheless, some Outreach Centres (ORCs) are very remote and require health workers,

the unsung heroes of the country's public health system, to walk for many hours, and sometimes even days, to reach the most remote facilities.

The most significant health problem in terms of developmental impact is the high rate of malnutrition. Though there has been improvement in recent years, it is nevertheless worrisome - some 33.5 percent of Bhutanese preschool children are stunted (BMIS 2011). From a long term perspective, sustainability of healthcare financing needs attention too. With the burden of non-communicable diseases (NCD) growing, health services at the district level are largely geared to serving the still existing burden of infectious diseases, such as common cold, diarrhea, skin diseases and conjunctivitis. In addition, alcoholism remains a significant health challenge, requiring multi sectorial behavioral interventions.

Education



Picture source: <http://c85c7a.medialib.gloster.com/media/57/5768287a78e0f6819406dd45075bcecb3a0f5ee99e01002c857bc968f475e0d7/education-in-bhutan.jpg>

Bhutan's education expenditures are equally strong. Public education expenditure stood at 7.3 percent of GDP and 16.7 percent of total government spending (MOF, 2012). These figures are amongst the highest in the South Asia region. The Constitution (2008) provides for the state to ensure free education up to Grade 10 for all children of school-going age, and to make technical and professional education generally available, and higher education

equally accessible to all on the basis of merit. At the same time, this progress has led to a refocus by development partners on other priorities, which may make it difficult to sustain high education spending.

Table 3: Poverty and Social indicators

| | 2000 | 2007 | 2012 |
|--|-------------------|--------------------|-------------------|
| Population below poverty line (%) | 36.3 | 23.2 | 12.0 ¹ |
| GNI per capita, Atlas method US\$ | 780 | 1,640 ² | 2,420 |
| Gross primary enrolment (%) ³ | 72 | 106 | 110 |
| Human development index | 0.58 ⁴ | 0.61 ⁵ | 0.54 ⁶ |
| Infant mortality (per 1,000 live births) (%) | 68.4 | 56.2 | 43.7 ⁷ |

Source: UN Publications, UNDP, World Bank, Bhutan National Statistics Bureau

¹ Bhutan Poverty Analysis, 2012

² 2008

³ Percent of school age population

⁴ 2003

⁵ 2006

⁶ World Human development index 0.69; Global ranking: 140

⁷ 2010

Bhutan is on track to achieve the Millennium Development Goals in education by the end of the 10th FYP (10FYP, 2008-2013). Bhutan has established an organized public education system since the 1960s. This diversified sector now includes over 650 schools and institutes, more than 180,000 students and nearly 9,000 teachers. Notably, gender parity has been achieved up to Grade 10. Females constitute nearly 50 percent of enrollment in higher secondary education and nearly 40 percent at tertiary level. The gross enrollment ratio was 71 percent at secondary level and 30 percent at tertiary level in 2011 (WDI 2011).

A key issue is that despite high enrollment and levels of public financing, learning levels remain low. Poverty remains a key constraint on enrollment and attendance. Gewogs where fewer children attend school tend to be those with comparatively high poverty rates. This is mainly due to high out-of-pocket expenditure for households.

Sector wide, the majority of education service delivery is through the public sector. The exception is higher secondary education (HSS, Grades 11-12) where 50 percent of the students are in private institutions. The 11th FYP expansion plan to

boost student numbers will require more intensive collaboration with the private sector and attention to school mapping to ease existing unbalanced patterns of participation in secondary education.

There is a growing role of private institutions and financing in the tertiary sub-sector. The 11th FYP expansion plans for tertiary education are ambitious but essential for Bhutan to build a human resource base to support a knowledge-based economy. Student intake is to increase to 15,000 (from just over 5,000 currently). To keep this from overburdening public expenditures, a greater role for the private sector is seen. But this raises new issues of quality and relevance. Since it will take the Education City some years to become operational, the Royal University of Bhutan (RUB) is the main reference point for the quality assurance and accreditation framework.

The government's recent decisions at the tertiary level are to adopt a single quality assurance model for both public and private tertiary institutions. This would involve endorsement of "accreditation" as the mode of quality assurance (as distinct from solely "audit" or "assessment"); and structure the QAA implementation procedures in three tiers, whereby "accreditation" is the third tier, preceded by registration and licensing of institutions (tier one) and self-appraisal and peer review (tier two).

Social Protection



Picture source: <http://www.fao.org/docrep/r6560e/r6560e0t.jpg>

In addition to the provision of free health and education, there is a formal system of social protection in Bhutan. However this was limited to about seven percent of the population. Coverage of Bhutan's pension system is limited to civil servants and joint-sector companies. These groups encompass under seven percent of the population in 2012. In addition, the armed forces are covered under a separate scheme. Participation in the National Pension and Provident Fund (NPPF) extends across some parts of the formal sector workforce beyond higher income groups, and a similar proportion of the elderly are receiving some benefits from the system. There is low coverage of the most vulnerable. Most of the poorest 20 percent have no social protection coverage. The lack of safety nets, particularly for those outside of public sector jobs, leaves the majority of the population vulnerable to shocks and risk. This seems to influence the decisions of the young people of Bhutan entering the labor market, with a majority of youth focused on the limited job opportunities in the public sector.

Employability of Bhutanese youth is a key priority. Employment opportunities for youth are limited, particularly at higher level managerial jobs (skills and job mismatch in market). The government target is to bring down the youth unemployment rate from 7.3 percent in 2012 to 5.0 percent or less by the end of the next plan period (2013-2018). Within this context, the Ministry of Labor and Human Resources (MOLHR) has decided to develop a social protection strategy to

provide more equity of social protection to those who work across different sectors, and provide support to senior citizens outside of the formal sector.

There are some existing specialized grant programs for those outside of the formal sector, including scholarships, and welfare schemes distributed by the King or by NGOs, but there is little coordination. Other support to the elderly comes through family and social networks. Changing social structures and rapid urbanization is likely to leave many elderly rural poor without informal social safety nets. Nine percent of the population is over 60, with more living in rural than urban areas, and this difference becomes even more prominent for those over the age of 70.

Agriculture



Picture source: http://blogs.adb.org/sites/default/files/styles/medium/public/bhutan_0.jpg?itok=ujYsUCNx

Bhutan is predominantly an “agriculture-based society”. The agriculture sector is dominated by smallholder subsistence farmers who occupy the majority of the arable land and produce most of the crop and livestock products. As per the Labor Force Survey Report of the MoLHR, 2012, the agriculture sector provides livelihood to 62.2 percent of the total population contributing to 12 percent of the total GDP.

While the contribution of agriculture to GDP has been declining, it continues to be an important sector. It is particularly important as a source of employment and for reducing poverty. But its growth has been insufficient to adequately address poverty, or deliver food security. Immigration from rural to urban areas, particularly by youth and men looking for a more modern life style, has

resulted in the feminization of the agriculture sector particularly in the lagging areas.

A range of policies are needed to improve rural life and maintain rural population.

Physical access to rural areas and between rural areas and markets needs to be improved. Dispersed and small scale production hinders adoption of good agriculture practices. Greater access to credit and technology, and sustainable approaches to pest and wildlife encroachment are all needed. Other issues include the loss of agriculture land for other development, lack of infrastructure such as irrigation, farm roads and post-harvest storage, labor shortage, and the scarcity of existing market traders and wholesalers.

The agriculture sector strategy in meeting 11th FYP (2013-2018) objectives:

To achieve eradication of poverty to less than 10 percent by the end of 2018, the sector needs to grow at an annual rate of four percent. The 11th FYP will adopt a multi-dimensional approach to develop the lagging regions. To achieve this, the Ministry of Agriculture and Forestry's key strategy will be to transform agriculture into a commercially viable sector that provides higher returns to farmers, improves rural livelihood, reduces imports and promotes exports, and offers attractive employment opportunities to youth.

Environmental Conservation



Picture source: <http://cdn.lightgalleries.net/4bd5ebf721640/images/bhutan021-2.jpg>

Environmental conservation is a cornerstone of Bhutan's unique development approach. Bhutan remains endowed with dense and virtually untouched forests, abundant water resources and diverse wild species. Nevertheless, it confronts chronic pressures primarily related to land degradation and biodiversity loss due to development and population growth. Land degradation can stem from inappropriate agriculture production and mining practices, overgrazing, and excessive forest harvesting, as well as solid waste disposal in and around population centers. Threats to biodiversity include illicit forest harvesting, human-wildlife conflict, poaching, and habitat fragmentation arising from land development projects.

A particularly important element is the need for integrated water management.

Despite the positive outlook for water availability, incipient challenges relate to the sustainability of urban water supply systems and functionality of existing rural water supply schemes. Ongoing soil erosion and deforestation threaten watershed conditions and their functional integrity. Concerns on water quality stem from the rise in domestic and industrial waste generation, along with improper disposal and run-offs from agricultural fields and urban centers.

The government has taken several important steps to preserve the environment.

Bhutan's environment policies include: (i) mandating a minimum forest cover of 60 percent of the country's total land area in the Constitution; and (ii) increasing the proportion of land under

protected area status to around 50 percent at present from 26 percent in 2000. It has established a permanent Land Management Unit for sustainable land management, and a plan for the Bhutan Trust Fund for Environmental Conservation (BT FEC) to adopt more modern governance and business practices. It has also launched a wildlife crime unit within the Department of Forest and Park Services including an online reporting system on wildlife offenses. Protection of the environment is also embedded in its Gross National Happiness (GNH) policies, including the need for investments to meet basic environmental and cultural standards.

Cultural Heritage Assets Management



Preservation and promotion of culture is one of the four pillars of GNH and of the Constitution, and is central to the government’s five-year development plans and its Vision 2020. It is also a key asset and economic driver especially through the tourism sector and as an alternative source of job creation for skilled masters and the educated youth.

While notable, the government’s cultural strategy has not paid enough attention to the country’s majority of non-monumental assets; villages and their immediate surroundings that have supported community life for centuries. These assets

are increasingly under threat from a number of unprecedented challenges. Economic liberalization of the country has brought an influx of “modern” influences and more materialistic aspirations, especially among young people. Ways of living, landscapes, and cultural practices, particularly those enshrined in rural communities and that have shaped Bhutan’s society for centuries, are being transformed in the quest for new lifestyles and less laborious job opportunities. Overall, the conservation of Bhutan’s broad cultural assets need to be prioritized as an integral element of city-wide growth planning, regional development, service delivery and poverty reduction programs.

The weakening of community vitality and loss of cultural assets has spurred the government to enact measures to formally steward its cultural heritage with an emerging emphasis on living landscapes. Within this context, Bhutan is starting to institutionalize a broad, inclusive range of policies, principles and practices to steer its development in a people-centered, culturally sensitive manner. These include the *11th Five Year Plan focus on “Prosperity for All”* aimed at raising awareness of the unique value of Bhutan’s traditional way of life as a driver for an inclusive and sustainable pattern of development, and the *draft Heritage Sites Bill* aimed at the stewardship of the very social fabric, properties and sites which have shaped Bhutan’s society, economy and landscapes.

These initiatives come at a critical time, as modernization is promoting changes in Bhutan that require a rethinking of the way the country has been developing, and the continuity of its cultural assets and values in the 21st century. These policies are not only expected to enlarge Bhutan’s definition of cultural preservation beyond monuments to address living areas, but also to increase the value of traditional skills and to create new employment opportunities and growth sources within a creative economy. Rural areas may particularly benefit through

increased demand for labor in the traditional construction and tourism sectors, supported by specialized training and establishment of centers of excellence. This may also contribute to create attractive employment alternatives outside overgrowing Thimphu.

By strengthening its own identity and integrity as a cultural landscape and protecting people's cultural assets, Bhutan will thus be better equipped to cope with powerful external economic and social pressures in a way that meets its aspirations to promote inclusive development, based on nonmaterial well-being, happiness, and cultural values.

Disaster Risk Management and Climate Change Adaptation



Bhutan is highly prone to disasters and climate related risks. Its rugged topography, geographic and climatic features make it prone to natural disasters such as earthquakes, glacial lake outburst floods (GLOFs), flash floods, landslides, and wind storms, as well as both man-made and natural fire disasters. Over the past 40 years, several earthquakes above a magnitude of six on the Richter scale have occurred. According to the World Bank report on Natural Disaster Hotspots (2005), 31.3 percent of Bhutan is in risk areas, and 60.8 percent of population is at high mortality risk from multiple hazards.

The frequency and intensity of extreme weather events appears to be increasing.

The country has become increasingly vulnerable to hydro-meteorological related disasters which may be an effect of climate change. It has become increasingly important to understand the changes in the climate and weather patterns to have reliable weather forecast and early warning systems in place.

Along with rising mean temperatures and glacial retreat, there is evidence of formation of supra-glacial lakes. Of the 2,674 glacial lakes in Bhutan, 25 have been identified as potentially dangerous. Natural dam formation and dam bursts that could release huge volumes of water pose a major risk to hydro-power plants, farmlands and human settlements. Strong winds have also become a noticeable cause of damage.

The government adopted the Disaster Management Act in 2013 to strengthen the disaster management system. The Act decentralizes disaster management activities, empowers the nodal institutions with the legal status to implement disaster reduction strategies, mandates the mainstreaming of DRM into all national plans and policies and emphasizes a consultative process at the national as well as the local levels. The National Disaster Management Authority (NDMA) will be formed in accordance with the Disaster Management Act 2013, which will be the highest decision making body on disaster management in Bhutan under the leadership of the prime minister. The Department of Disaster Management (DDM) under the Ministry of Home & Cultural Affairs - the national coordinating agency for all disaster management activities, will serve as the executive arm and secretariat to the NDMA. The DDM is formulating a comprehensive National Disaster Risk Management Strategy for Bhutan which will guide DDM and all other relevant stakeholders in carrying out disaster management activities prioritized as short, medium and long term. Key challenges include (i) strengthening preparedness and early warning systems; (ii) mainstreaming disaster risk management, including in

construction; and (iii) strengthening disaster response capacity.

Urban Development



Bhutan is undergoing a rapid transition from a rural economy to an urban society. The average annual urban population growth rate has been around four percent since 2007. The Bhutan National Urban Strategy (NUS, 2008) projects that by 2020, the country will be most likely 60 percent urbanized. As Bhutan evolves into a more urbanized society, the government recognized the country's unique challenges in urban development: the rapid rates of urbanization; and the limited availability of serviced land.

The urbanization rate across the country is skewed toward the Western region. Thimphu and Phuentsholing are the two most favored destinations for migrants. Through the enactment of the Local Government Act (2009) and the approval of the Municipal Finance Policy (2012), the government has established four autonomous cities (Thimphu, Phuentsholing, Gelephu and Samdrup-Jokhar). Under the proposed National Urban System, these centers would play an important role as future engines of growth.

Bhutan is relatively well positioned to meet the challenge of rapid urbanization, given its low population. Nevertheless, urban institutional and governance systems need to be strengthened. Spatial planning is also needed, as lack of affordable and housing for lower-income groups is becoming a critical issue. Another important issue is to provide for jobs for an increasingly urban youth population.

Energy



Picture source: <http://www.bbs.bt/news/wp-content/uploads/2012/08/SharingEnergy.gif>

Hydropower development has underpinned the rapid growth of Bhutan's economy. The total installed capacity of existing hydropower plants is 1,480 megawatts (MW). Of total annual power generated, 80 percent is exported to India after meeting domestic consumption. Power exports account for the largest source of national revenue in the form of taxes and dividends, generating more than 40 percent of government revenue. Power exports also contribute to 25 percent of gross domestic product (GDP), and hydropower infrastructure development contributes another 25 percent of GDP through the construction sector.

However, power generation can get disrupted during winter months. During wet seasons existing hydropower plants can generate sufficient electricity to meet domestic demands and power exports. Nevertheless, since all the existing plants are run-of-the-river, the total generation capacity drastically drops to around 288 MW during winter dry seasons (December–March). This low capacity does not meet the system peak demand during winter dry seasons. To deal with the seasonal power shortage, industrial loads have been curtailed during the winter months. Winter power shortages will likely remain until 2016 when the Punatsangchhu-I hydropower plant (1,200 MW) is expected to come online.

In 2008, Bhutan agreed to develop and export 10,000 MW of new capacity to India

by 2020. Under the bilateral framework, one project at Punatsangchhu (stage 1, 1,200 MW) has started construction and contracts for two projects at Punatsangchhu (stage 2, 1,020 MW) and Mangdechhu (720 MW) have been awarded. Seven other large hydropower projects are at various development stages with the Indian government and its own enterprises.

In addition, small and medium sized hydropower operations are being developed as public-private partnerships (PPPs). In 2008, the Asian Development Bank (ADB) agreed to finance the Dagachhu hydropower project (126 MW) as the first PPP infrastructure in Bhutan. The project's joint venture was established between DGPC and India's Tata Power Company. The Department of Hydropower and Power Systems also intends to promote independent power producers (IPPs) as the next step after formulating rules and guidelines required for IPPs.

The hydropower development will require extensive investments in power transmission. While these transmission lines are expected to be developed and aligned with hydropower development, a holistic development approach will be crucial for the network expansion to maximize the investment benefits and minimize any adverse safeguard impacts on transmission corridors.

Bhutan has set an ambitious goal of providing electricity for all by 2015. Mountainous terrain and the resultant difficulties of grid extension have kept some of the rural population without access to clean energy. Traditional fuels, such as kerosene and fuel wood, cause indoor pollution and health burdens. To reduce poverty and stimulate inclusive economic development, the government has embarked on a large-scale rural electrification campaign. As of December 2012, 84 percent of households had access to electricity, supported by the ADB and JICA. In addition to

grid extension to rural areas, households in remote villages may have access to electricity through standalone solar home systems.

Bhutan has also begun to develop renewable energy to diversify the energy supply base through wind, solar, biomass, and small and micro hydropower. Wind power projects have the potential to generate clean energy to supplement hydropower in winter dry seasons. Bhutan also has biogas development potential as an alternative energy source to replace fuel wood for cooking in rural areas. Rural households depend heavily on fuel wood, which emits indoor air pollutants and poses a health hazard. To promote renewable energy, a national policy must be established and financial and fiscal incentives provided to help overcome the entry and financial barriers for development.

Transportation



Transportation is a critical constraint in the provision of affordable rural access to social and economic services and facilities in Bhutan. For instance, the Bhutan Living Standards Survey (2012) reports that transportation services alone account for approximately 23 percent of the cost incurred where households sought health care to address sickness or injury. According to Bhutan's 2010 Investment Climate Assessment, transportation is the biggest infrastructure problem encountered by firms in Bhutan. Roughly 40 percent of all firms and 70 percent of large firms surveyed had experienced losses due to ground transportation difficulties.

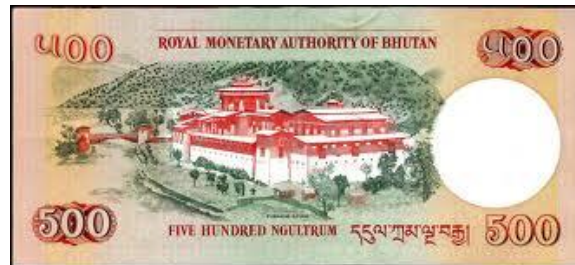
Bhutan has achieved significant milestones in the transport sector. Investments under the 10FYP have helped increase connectivity towards the official goal of having 85 percent of the population within half a day's walk from the nearest road. Parliament has also passed the Road Act in 2012 which empowers the Department of Roads to coordinate various institutions working in the roads sector. These accomplishments show a strong government commitment to developing Bhutan's transport sector and the institutions that will sustain it into the future. Recent physical achievements, supported by a World Bank project, that benefited 12,000 rural residents in three dzongkhas, include: (i) 67 km of new roads, (ii) 24 km of improved roads; and (iii) seven newly constructed motorable bridges. Project beneficiaries have experienced a 62 percent reduction in travel time to reach

socio economic facilities (schools, clinics, etc.).

Looking forward, Bhutan Transport 2040 envisages meeting increased demand for rural transport with a dzongkhag road network that is 3-½ times its current length with connections to every gewog. Achieving such targets will require approximately 2,500km new roads. Bhutan Transport 2040 also targets major investments such as: (i) widening of the existing East–West Highway (and other key routes) to two lanes; (ii) improving access routes between industrial centers and major border crossings; and (iii) improving various existing alignments along the national highways network to improve safety and travel times. Bhutan also needs to strengthen the technical systems used for prioritizing, planning, and implementing essential maintenance activities for the sustainable development and management of the national transport network.

Improving quality and availability of urban transport services is also a key priority. The number of Bhutanese living in urban areas nearly tripled between 1990 and 2010. Increasing rates of motor vehicle ownership and use have accompanied this trend, creating unprecedented impact on the urban environment (many negative, including emissions, congestion, noise, etc.). Bhutan’s urban transport systems are still developing to meet increasing demand for urban mobility. Nevertheless, less than one third of urban households in Bhutan report using public transport in a given month.

Governance, Public Financial Management and Procurement



Bhutan outperforms its neighbors on Transparency’s International’s Corruption Perception Index. In 2012, Bhutan moved further up the index, from 38th to 33rd, in recognition of additional steps it has taken to strengthen its anti-corruption legal framework, including passage of the 2011 Anti-Corruption Act, the establishment of an Anti-Corruption Commission (ACC), and further strengthening of rules governing asset declaration by public servants in 2012. In 2013, Bhutan has moved further up to be ranked 31. A key element for improving governance has been an ambitious government-to-citizen program to provide services electronically through community centers, which is particularly important in light of geographical barriers. Similarly, with support from the IFC, the government has developed a government-to-business e-portal to provide a comprehensive inventory of licenses and other information on business processes.

Public financial management (PFM) reforms are part of national priorities. Bhutan over the years has been making progress in the area of accounting, budget execution oversight, control and reporting. Parliamentarians increasingly pay attention to the budget approval process and also in reviewing the audit observations through public accounts committee. The government continues to take steps for strengthen PFM in the country. The public at large has also become more demanding in terms of transparent and efficient government. Nevertheless, further improvement is needed on oversight of public sector entities, predictability in funds available for

expenditures, the quality and timeliness of budget reports and financial statements, implementing the standards on auditing and accounting, PFM information systems, availability of professionally qualified staff and effectiveness of internal audits. Bank has provided an IDF Grant to help the government in strengthening PFM in the public and private sectors in Bhutan by strengthening internal audit in public sector, assist in the implementation of Bhutanese Accounting standards (BAS) and strengthening public accounting functions of RGoB.

Significant progress has been achieved on public procurement reforms. Among the outcomes are: (i) the introduction of the procurement rules and regulations 2009 and standard Bidding Documents for Goods, Works and Services in April 2009; (ii) the establishment of the Public Procurement Policy Division in August 2008; (iii) the career path and recruitment tools put in place for a procurement profession; (iv) the generally well-functioning procurement market; (v) a strong framework for control and audit, spearheaded by the Royal Audit Authority and the Anti-Corruption Commission; (vi) set up of the Government Procurement and Property Management Division to conduct centralized procurement of common items; and (vii) an independent review body to handle procurement grievances has been constituted. Because of this progress, the World Bank is moving towards use of country systems for all procurements up to the International Competitive Bidding Thresholds in Bhutan from end FY 2014-15.

The World Bank Program in Bhutan



The current joint World Bank/IFC-Bhutan Country Partnership Strategy (CPS) covers the period FY11-14. It is aligned with three key strategic frameworks –

the Principles of Gross National Happiness (GNH); Bhutan 2020 Vision; and the Tenth Five-Year Plan (2008-2013). The CPS has two areas of engagement: (i) Economic Diversification, Job Creation and Financial Inclusion; and (ii) Spatial Planning and Public Services, with two cross-cutting themes: capacity building and environmental sustainability.

The World Bank provides around \$15-20 million of new IDA resources per year.

There are four ongoing specific investment operations for a net commitment of \$82 million of IDA resources. These include three country specific IDA operations – Decentralized Rural Development, Urban Development II, Remote Rural Communities Development – one regional IDA project – Regional Cooperation on Wildlife Protection – and one GEF grant operation – Sustainable Financing for Biodiversity Conservation. An additional financial project of the Urban Development II is being prepared. In addition, the WB manages several grants for Bhutan on Disaster Management, Public Private Partnerships, Corporate Governance, Public Financial Management and inter-governmental fiscal relations, Urban Budget Processes, and social protection.

The World Bank has extended three development policy operations over the last six years.

The most recent, Development Policy Credit-2 (DPC-2) was approved by the World Bank's Board of Executive Directors in November 2012 for a total of \$36 million. This operation has focused on: (i) Promoting government efficiency and effectiveness through sound fiscal and public financial management and procurement, and strong

public administration; (ii) Fostering private-sector development by improving the policy environment and facilitating productive employment opportunities; and (iii) Expanding access to infrastructure in a sustainable manner.

The World Bank provides support on knowledge through analytical work and technical assistance. Recent analytic work includes a Gender Policy Note, a Nutrition Assessment, a Poverty and Social Impact Analysis of the proposed Bill on Cultural Heritage, a Human Development Public Expenditure Review, a review of higher education, and an Investment Climate Assessment, which served to underpin the most recent budget support operation (DPC-2) to improve the policy framework governing private sector development. A poverty assessment, Financial Sector Assessment and a green growth study are underway, as well as financial sector technical assistance to support the design of a financial sector strategy.

The next CPS is scheduled to begin in FY 2015. It is anticipated that many of the themes of the current CPS will continue to resonate. The bulk of IDA financing is expected to continue in the form of development policy lending, supplemented by a limited number of specific investments in key areas, particularly where IDA resources may be leveraged, and a robust knowledge program. The next CPS probably will also reflect a shift toward IDA-IBRD blend status for Bhutan, in keeping with Bhutan's emerging middle-income country (MIC) status.

International Finance Corporation (IFC)



The IFC has a total committed investment portfolio in Bhutan of over \$31 million. The portfolio consists predominantly of IFC's recent equity participation in Bhutan National Bank. The advisory portfolio includes advice in structuring Public Private Partnerships (PPPs), improving Bhutan's investment climate and enhancing access to financial services. IFC continues to explore areas of assistance in hydropower, tourism, manufacturing, agribusiness, health and education sectors among others. IFC's advisory support on investment climate reforms, PPP development and the financial sector is expected to continue.

Multilateral Investment Guarantee Agency

In January 2013, Bhutan took the first step to becoming a member of MIGA by signing the MIGA Convention. The Convention has been ratified by the National Assembly and the National Council. Bhutan is currently in the process of completing the other requirements for membership. Upon completion of the membership process, MIGA will be able to support investments in Bhutan by providing guarantees.



BHUTAN: Decentralized Rural Development Project (DRDP) Additional Financing

Key Dates:

Approved: March 21, 2011
 Effective: April 26, 2011
 Closing: December 31, 2014

Financing in million USDollars*:



| Financier | Financing | | |
|--------------------|-----------|-----------|-------------|
| MDTF | 5.00 | | |
| Total Project Cost | 5.00 | | |
| Financier | Total | Disbursed | Undisbursed |
| MDTF | 5.00 | 4.9 | 0.1 |

*As of March 2014

Project Background:

The Decentralized Rural Development Project (DRDP) was approved on March 1, 2005 for a credit of \$7 million. Effective March 21, 2011, under the Global Food Crisis Response Program (GFRP) Multi-Donor Trust Fund, a grant for \$5 million was allocated to Bhutan as additional financing for the DRDP. The additional DRDP grant funds were to help finance the costs associated with scaled-up activities and to address the impact of the continuing high prices associated with essential food commodities. Due to significant exchange rate savings/gains the project was restructured and the closing date extended to December 31, 2014.

Project Development Objective and brief component description:

The project development objective is to improve market access and increase agricultural output for rural communities in selected areas of Bhutan. The project supports improvements/rehabilitation of rural infrastructure (rural roads and irrigation) and promotes extension activities particularly for rice, maize and potato crops to address disease outbreaks and low productivity.

The DRDP Additional Financing supports three components. The first component focuses on the rehabilitation and construction of irrigation canals and on the improvement of selected roads which support rice, potato and maize production areas. The second component helps farmers improve production of rice and maize through demonstration, knowledge sharing, improved technologies and capacity building. Finally, the third component focuses on institutional strengthening activities such as capacity-building at the local-level administration, for planning aspects, and for the physical reporting of project implementation performance, to ensure the appropriate transfer of funds to the local level. In addition, capacity building activities for pest surveillance, financial management, environmental and social screening will be supported.

Results:

- The project is on course to achieving its targets in improving rural infrastructure (irrigation canals and farm roads) and food crop production (rice, maize and potato). To date the project has benefitted over 8,272 households (target 6,700 households) from improved infrastructure and over 8,703 households (target 8,500 households) through improved extension services.
- 43.95 km of farm roads have been improved exceeding the end of project target of 15 km. Similarly, 256 km out of a required 200 km of irrigation canals have been rehabilitated.
- In the last cropping season Jan-Feb 2013, 111 tons of basic seeds of potatoes were produced. With the increase in number of contract farmers for seed production and also with the increase in National Seed Center (NSC) area for cultivation, the total basic seed production is expected to exceed the 700 metric ton target by the project closing date. The multiplication of seeds of new rice, maize, and potato varieties has started, and is expected to be increasingly adopted by farmers. The adaptation rate for improved rice varieties is 45 percent against a project target of 25 percent. On the other hand 27 metric tons of Green Leaf Spot (GLS) disease tolerant maize seeds were produced by community based seed production (CBSP) groups, resulting in 60% of GLS affected maize seeds being replaced. The target replacement rate for the project is 80 percent.

Key Partners: Ministry of Agriculture and Forests

BHUTAN: Second Urban Development Project (BUDP2) (P090157)

Key Dates:

Approved: April 29, 2010
 Effective: August 24, 2010
 Closing: December 31, 2015

Financing in million USDollars*:

| Financier | Financing | Disbursed | Undisbursed |
|----------------------------|-------------|------------|-------------|
| IDA | 12.0 | 5.0 | 6.7 |
| Royal Government of Bhutan | 0.7 | | |
| Total Project Cost | 12.7 | 5.0 | |

*As of June 30, 2013



Project Background:

The Kingdom of Bhutan has experienced rapid social and economic development over the past two decades, and this socio-economic transition is fueling rapid urbanization. Meeting the challenges of urban development, management and finance is now a key developmental agenda of the Royal Government of Bhutan (RGOB) and its international development partners. The World Bank started its support with the Bhutan Urban Development Project (1999-2006), which helped develop urban infrastructure systems in ten secondary towns. The RGOB showed strong interest and appreciation of the Bank's policy advice through the project and technical assistance to prepare the National Urbanization Strategy (2008) and the Thimphu City Development Strategy. On the RGOB side, the Local Government Act of 2009 and Municipal Finance Policy (2012) provide the framework for the roles and responsibilities of urban local governments. In that context, the ongoing BUDP2 focuses on supporting urban/municipal development in Thimphu (the capital and Bhutan's largest city) and Phuentsholing (second largest city and a commercial hub) as well as technical assistance for the urban local governments and the Ministry of Works and Human Settlement.

Project Development Objective and brief component description:

The project development objectives are to (i) support Bhutan's municipal reform program by strengthening municipal finance and management services in Thimphu and Phuentsholing; and (ii) improve infrastructure services in northern Thimphu where no formal services are currently available.

The BUDP2 consist of three components: (i) municipal Finance and Management; (ii) Thimphu Northern Area Development; and (iii) Capacity Building. *Component 1 (\$1.5 million)* aims at strengthening the institutional systems of Thimphu and Phuentsholing Thromdes (city corporations). The support for the city-specific reforms is being done broadly through (i) strengthening the local revenue administration systems and processes; and (ii) strengthening the expenditure management systems and financial management systems and processes of the two Thromdes. This component also supports Royal Government policy reforms aimed at setting up a policy framework for municipal financing. *Component 2 (\$9.3 million)* supports the development of basic infrastructure systems in two 'local area plans' in northern Thimphu, including roads, stormwater drainage, water supply, sewerage and street lighting, as well as support for increase in low-income housing units in these areas. Under *component 3 (\$1.2 million)*, resources are being provided for training programs, equipment, technical assistance, and studies based on the needs of Thimphu and Phuentsholing Thromdes. It aims at significant upgrading of each Thromde's capacities in various aspects of their internal work processes and service delivery to citizens through training of operational staff and provision of relevant equipment.

Key Results: [Target Values at end of Project]

- Increase in local revenue collection: 50 percent by Thimphu and 40 percent by Phuentsholing.
- New building permits issued for serviced plots: 175 (in two Thimphu Local Area Plans being developed)
- Number of households with new piped water and sewerage connections: 600 (in two Thimphu Local Area Plans).
- Number of municipal staff trained: 250 (with 150 in Thimphu and 100 in Phuentsholing)

Key Partners: Ministry of Works and Human Settlement, Ministry of Finance, RGOB; Thimphu and Phuentsholing Thromdes.

BHUTAN: Thimphu Strategic Cultural Heritage and Sustainable Tourism and Implementation of Priority Actions

Key Dates:
 Approved:
 Effective:
 Closing: June 30, 2014
Financing in million US Dollars*: 255,000

| Financier | Financing | Disbursed | Undisbursed |
|---------------------------------------|-----------|-----------|-------------|
| MDTF (Governments of India and Italy) | | | |
| Total Project Cost | 255,000 | 81,592.69 | 173,407.31 |

*As of June 30, 2013



Project Background:

The Kingdom of Bhutan emphasizes preservation of its culture, environment, and identity, while pursuing economic growth. The country's unique development agenda, based on the concept of Gross National Happiness, highlights a synergistic and harmonious balance between material well-being and the spiritual, emotional, and cultural needs of individuals and society. As Bhutan pursues this goal, however, the country is experiencing a profound and rapid transition from a largely subsistence rural economy to a more urban society. This rapid urbanization is threatening the country's traditional buildings and historic sites and undermining the practice of traditional arts and crafts. It is important that these skills and traditional knowledge are conserved because: (a) built heritage represents the country's unique style of architecture and urban design and preserves centuries of insights on adaptation to local topography and climatic conditions; (b) traditional arts and crafts express the culture and identity of the country and are an important source of social cohesion; and (c) the country's cultural assets provide much of the basis for Bhutan's competitiveness in high-value, low-volume tourism. As the country responds to new and evolving challenges, cultural heritage conservation can be a dynamic force for its sustainable development. The proposed grant activity will pilot conservation-led urban planning to respond to Bhutan's goal of preserving and promoting cultural values, which is a main pillar of the government's development philosophy. The focus will be Thimphu, the country's largest city and its economic, administrative, and tourism center.

Project Development Objective and brief component description:

The PDO of this activity is to incorporate cultural heritage and sustainable tourism in the economic development of Thimphu and surrounding peri-urban areas, and create income-earning opportunities in the heritage conservation and cultural tourism sectors for unemployed youth, women, and other vulnerable groups. The project consist of three components:

Component 1: Strategic Cultural Heritage and Sustainable Tourism Development Plan – Update of Thimphu Structure Plan. This component supports (a) the review of the Thimphu Structure Plan (notified in 2004), and (b) the updating and expansion of its cultural heritage and tourism elements of that plan in order to protect heritage and integrate culture into the broader economic development of Thimphu. The activity will address cultural heritage as both a national and local priority and involve the hiring of an international consultant to work with local planners, a series of stakeholder workshops, and production of a planning document.

Component 2: Improvements at Changangkha Lhakhang. Component 2 finances improvements to this iconic temple founded in the 12th century that is of great importance for Bhutanese and is a primary tourist destination in Thimphu. The investments are based on a plan prepared by the MoWHS and approved by the Ministry of Home and Cultural Affairs and other key agencies. Grant funds are used to address conditions that are undermining the sanctity, safety, and sustainability of Changangkha Lhakhang.

Component 3: Capacity Building and Awareness Raising for National and Local Government Institutions and the Private Sector. This component is a direct response to Bhutan's rapid urbanization, rising standards of living, escalating land prices, increasing costs of maintenance, and the pace of reconstruction after the 2011 earthquake, all of which are factors contributing to new construction and inappropriate repair of traditional structures that disrupt the visual harmony and value of Bhutan's urban areas. To assist with conserving one of Bhutan's most important cultural assets, its traditional architecture and urban landscapes, the MDTF is financing the preparation, publication, and dissemination of Bhutanese architecture guidelines under this component.

Key Results: This activity is expected to result in:

- Increased stakeholder participation in decision making related to heritage conservation and tourism development
- Improved access, safety, and sustainability of a cultural heritage site important to the local population and tourists.
- Increased awareness and appreciation of local cultural assets
- Increased national and local commitment to safeguard cultural heritage

Key Partners: Ministry of Works and Human Settlement (MoWHS) and Thimphu Thromde

BHUTAN: Sustainable Financing for Biodiversity Conservation and Natural Resources Management (P127490)

Key Dates:

Approved: May 15, 2013

Effective: *Grant signature expected in July 2013 and effectiveness by September 2013*

Closing: December 31, 2018

Financing in million USDollars*:

| Financier | Financing | Disbursed | Undisbursed |
|--------------------|-----------|-----------|-------------|
| IBRD | | | |
| IDA | | | |
| Other – GEF | 4.08 | 0 | 4.08 |
| Total Project Cost | 4.08 | 0 | 4.08 |

*As of June 30, 2013



Project Background:

As development proceeds apace (8 percent average growth in the past three decades), Bhutan is facing pressures on its natural endowment stemming from population growth, agricultural modernization, hydropower and mineral development, industrialization, urbanization and infrastructure development. In keeping with Bhutan's enduring national commitment to protecting the environment, one of the five main development objectives included in Bhutan's 20-year perspective of development goals, *Bhutan 2020: A Vision for Peace, Prosperity and Happiness* is environmental conservation. Nevertheless, conservation efforts have been challenged by an inadequate system of prioritizing the wide range of environmental needs, weak institutions and capacity as well as limited financing. In recognition of the constraints, the government established the Bhutan Trust Fund for Environmental Conservation (BT FEC) in 1992. A GEF grant of \$10 million implemented during 1992-97 helped to create a permanent, well capitalized institution. In comparison to BT FEC's notable growth in capital from bilateral donor contributions and careful management of investments, its grant-making performance has been modest and below its potential. With the socio-economic development needs of a modernizing and growing population especially with the advent of constitutional democracy in 2008, BT FEC's challenge has become more formidable. It needs to gain greater prominence, authority and credibility as an effective and reliable institution for sustained funding of conservation activities and for setting annual conservation priorities.

Project Development Objective and brief component description:

The project development objective (PDO) is to improve the operational effectiveness and institutional sustainability of the Bhutan Trust Fund for Environmental Conservation. The project components are: (1) enhancing the operational effectiveness and sustainability of BT FEC by adopting more modern governance and business practices and ensuring the adequacy of its resources and tools going forward; (2) improving conservation management of the high altitude northern areas (HANAS) that support a globally important ecosystem under threat from population growth, patterns of agricultural cultivation, livestock grazing and urbanization; and (3) capacity building for mainstreaming of conservation and sustainable forest and natural resource management approaches into national policies, strategies and plans.

Results:

Grant effectiveness is expected by September 2013.

Key Partners:

Bhutan Trust Fund for Environmental Conservation
 Ministry of Agriculture and Forests, Royal Government of Bhutan

BHUTAN: Remote Rural Communities Development Project (RRCDP)

Key Dates:

Approved: October 2, 2012
 Effective: November 15, 2012
 Closing: May 31, 2018

Financing in million USDollars*:

| Financier | Financing | Disbursed | Undisbursed |
|--------------------|-----------|-----------|-------------|
| IDA | 9.00 | 1.3 | 7.9 |
| Total Project Cost | 9.00 | | |

*As of March 2014



Project Background:

The Remote Rural Communities Development Project (RRCDP) project area covers 26 geogs in 6 dzongkhags located in south-western and south central Bhutan. The RRCDP is designed to improve living conditions and incomes in the country's poorer and more remote rural areas. The populations in these areas currently rely on subsistence agriculture, and lack roads, irrigation, technologies, and community and social infrastructure that would allow them to improve their incomes and social integration.

Project Development Objective and brief component description:

The main objective of the project is to increase agriculture productivity and access to community assets in remote rural areas by improving access to markets, irrigation, agricultural technologies, and community infrastructure. Improvement in market access would be achieved by investments in farm roads and marketing infrastructure. Agricultural productivity and rural incomes would increase through promotion of improved irrigation and agronomic practices and rehabilitation of productive assets for key commodities. Community-led investments will improve the access of the poorest people to the critical and missing infrastructure in the selected area. The RRCDP consists of three components:

Component A. Rural Infrastructure: The focus of this component is to connect the communities to larger roads and regional markets and to improve production potential through improved availability of irrigation.

Component B. Community, Marketing and Productive Infrastructure: This component would cover investments in marketing and post-harvest infrastructure, critical community-level infrastructure, and investments identified by producers to increase agricultural productivity.

Component C: Project Management and Institutional Strengthening: This component supports project management, including the monitoring and evaluation functions of the project. It covers: (a) technical and financial management; (b) procurement; and (c) supervision of compliance with environmental and social safeguards. This component will strengthen the capacity of the MoAF to effectively coordinate implementation and provide procurement support to local communities as needed.

Results:

- The Remote Rural Communities Development Project became effective mid-November 2012 and had its first implementation support mission in March 2013. It is therefore too soon to assess progress against the PDO or report on results in relation to the intermediate outcome indicators.
- The project management team has been taking proactive steps to develop 18-month work plans for the project components; identification of geogs where project activities will be first implemented; started the recruitment process including the preparation of TORs for key staffing positions; and currently updating its operations manual and procurement plans.
- The PDO indicators are:
 - Productivity of crops increased by at least 20 percent in targeted irrigation systems
 - Marketed value of agricultural production increased by 20 percent in targeted area
 - Share of beneficiaries with access to critical community infrastructure increased by 20 percent in targeted area
- The project is expected to directly benefit about 6,440 rural household living in the project area.

Key Partners: Ministry of Agriculture and Forests (MoAF)

BHUTAN: IFC'S EQUITY INVESTMENT IN BHUTAN NATIONAL BANK

Key Dates:

Approved 20 December 2012

Effective: 31 December 2012

Closing: n/a

Financing in million USDollars*:

| Financier | Financing | Disbursed | Undisbursed |
|--------------------|-----------|-----------|-------------|
| IBRD | | | |
| IDA | | | |
| Govt of --- | | | |
| Other - IFC | 28.5 | 28.5 | 0 |
| Total Project Cost | | | |

*As of June 30, 2013



Project Background:

Bhutan faces a set of challenges typical of countries seeking to make a rapid transition from a mostly rural, agrarian society to one characterized by increasing levels of education, a large number of young people looking for more opportunities and, with increased globalization, shifting expectations and aspirations on the part of its population. It is critical for a country with such potential, yet facing a diverse set of challenges, to foster private sector-led growth and poverty alleviation. Strengthening of the banking sector is a key pre-requisite in this.

Project Development Objective and brief component description:

This landmark investment by IFC in a leading commercial bank in Bhutan is one of IFC's most significant and impactful investments in South Asia. IFC's \$28.5 million investment for 20 percent stake in Bhutan National Bank (BNB) marked the following milestones: IFC's first equity investment in Bhutan, IFC's fourth and largest investment in Bhutan to date, and for the country, the largest investment to-date by a foreign investor. The project brings together IFC's two pillars of investment and advisory services to achieve optimal results for the client. IFC's funding will help expand the bank's outreach into the underbanked population of Bhutan. By capitalizing on BNB's strong platform to reach underbanked SMEs, the expected improved access to finance will help address a key impediment to private sector competitiveness.

Results:

The project will have a strong development impact on many fronts. It will initiate and generate: (i) increased access to finance in Bhutan, a frontier market, with a sizeable underbanked and rural population, which will also support inclusive growth and job creation in the country; (ii) benefit Bhutan by providing BNB with access to international best practices in the areas of IT, risk management, social and environmental management and corporate governance, (the latter three are initiated) and by assisting the Bank in implementing its new growth strategy and expanding into new underserved market segments; (iii) positive influence on the country's developing financial market and strengthening of the country's investment climate by introducing international guidelines and standards, thereby reducing systemic risk; and (iv) improvement in overall financial intermediation by promoting beneficial competition in the country's banking sector.

Key Partners:

Bhutan National Bank, Royal Monetary Authority, Ministry of Economic Affairs, Ministry of Finance.

BHUTAN: AMANKORA

Key Dates:

Approved:12/11/2003

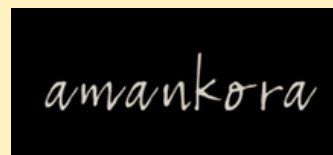
Effective:

Closing:12/19/2003

Financing in million USDollars*: US\$10 million

| Financier | Financing - | Outstanding | Undisbursed |
|--------------------|----------------|--------------|-------------|
| IFC | US\$10 million | US\$2million | |
| IDA | | | |
| Govt of --- | | | |
| Other | US\$8 million | | |
| Total Project Cost | US\$18 million | | |

*As of June 30, 2013



Project Background:

The Amankora project involved the construction of five luxury guest-house type resorts at different locations in Bhutan. The project operates under the Amanresorts brand of hotels which is recognized in the tourism industry for its ability to create high-end resorts in unique/frontier destinations. Project is funded with a with a long term loan of \$10 million and an equity of \$8 million.

Project Development Objective and brief component description: The project contributes to the development of the tourism sector in Bhutan, more specifically the project has the following development impacts:

- Created a demonstration and catalytic effect with regard to attracting private investment into Bhutan in general and to higher end hotels in particular (The Uma, Taj etc);
- Direct and indirect job creation;
- supports the government's 'high value - low impact' approach to expanding the tourism sector in Bhutan by attracting high spending, environmentally conscious and culturally interested visitors to the country;
- transfers international best practices in hotel management, including service and quality standards, occupational health and safety, and environmental management, by an experienced sponsor to the emerging Bhutanese tourism industry;
- reduces the risk of the dominance of the Indian Rupee on Bhutan's foreign exchange reserves by generating US dollar revenues for the country; and
- encourages utilization of a significant proportion of goods and services required by the resort guests from local sources which will help develop the local supply base and encourage the growth of SMEs;

Results: Bhutan appeals to world travelers seeking exotic locations and unique habitats. Amankora Resorts helped address limited hospitality infrastructure to enable the country to take advantage of its natural beauty to attract the tourist trade. The construction of the five lodges has resulted in the creation of 400-plus jobs. These developments have also stimulated an arts community, as local craftspeople, artisans, and performers benefit from tourist spending.

Key Partners:

The sponsors of the Amankora project are: (i) Bhutan Hotels Limited (BHL), a company incorporated in Bhutan and fully owned by Silverlink Holdings Limited a BVI-registered company and the owner of the Aman resorts brand of luxury hotels; and (ii) Bhutan Tourism Corporation Limited (BTCL), a publicly listed Bhutanese company and the third largest tour operator in Bhutan.

Bhutan: Licensing Simplification Project

Key Dates:

Approved: November 4, 2010
 Effective: November 4, 2010
 Closing: June 30, 2014

Financing in million USDollars*:

| Financier | Financing | Disbursed | Undisbursed |
|---------------------------|-----------|-----------|-------------|
| IBRD | | | |
| IDA | | | |
| Govt of --- | | | |
| Other | \$0.522 | \$0.446 | \$0.076 |
| Total Project Cost | | | |

*As of June 30, 2013



Project Background:

According to Doing Business 2010, Bhutan’s ranking in ease of doing business and starting a business was #126 (#124 in 2009) and #80 (#66 in 2009) respectively. In this context, the Royal Government of Bhutan undertook a broad scope of reforms to improve efficiency of its services. The Economic Development Policy (2010) set the goal of reducing the burden of compliance through elimination of overlapping approvals and streamlining requirements for business start-up and operations by 2011.

As requested by the government, IFC conducted an inventory of business licenses and identified 119 licenses (issued by 29 agencies). The inventory also identified business entry constraints such as, inefficient and cumbersome procedures related to ex-ante licenses, systemic shortcomings including gaps in the regulatory basis, duplication of information required by different issuing agencies, and poor access to information which affects both domestic and foreign investors.

To improve business licensing in Bhutan, IFC designed this project to play a special role by focusing on the in-depth analysis of key technical licenses, bringing knowledge of good international practice and corresponding regulatory changes. In addition, the project covers system-wide reforms to introduce good practice in business licensing and to develop an electronic Licensign e-portal containing information related to business licenses.

Project Development Objective and brief component description:

This project will help the Royal Government of Bhutan (RGoB) improve regulatory requirements underlying selected business licenses and promote streamlining, and achieve at least 25 percent time savings to the private sector due to process streamlining of three selected priority licenses, and better availability, quality and transparency of licensing information with a targeted 10 percent reduction in compliance costs for entry licenses made more accessible through improved provision of information.

Licensing Policy: The project is supporting the government to adopt a Licensing Policy to apply international good practices in business licensing.

Information Access: The project is supporting the government to improve information both online (www.g2b.gov.bt) and at the issuing agencies’ offices.

Priority License Reform: The project identified three priority licenses namely, FDI Approval, Project Approval and Environmental Clearance for in-depth reform.

The project has aimed to contribute to the following impacts by April, 2015 (i.e. three years after project completion)

- \$1 million compliance cost savings;
- \$10 million FDI facilitation.

Results:

- G2B Licensing e-Portal developed and launched. PM issued Executive Order prioritizing the e-Portal for G2B interface.
- Information about licensing made more available through Information Charters and Brochures for 11 pilot licenses.
- FDI Approval process and Policy streamlined making it significantly faster to get FDI approvals. For the priority sectors the time reduction is from 213 days to 10.5 days and compliance cost savings is \$1.07 million.
- Domestic Project approval for medium and large businesses has been streamlined making it faster and easier.

Key Partners: Ministry of Economic Affairs, Gross National Happiness Commission, National Envir. Commission, Ministry of Finance