Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 20-May-2019 | Report No: PIDC27030
## BASIC INFORMATION

### A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
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<tbody>
<tr>
<td>Bhutan</td>
<td>P168166</td>
<td>Strengthening Fiscal Management and Private Sector Employment Opportunities (P168166)</td>
<td>P164290</td>
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<table>
<thead>
<tr>
<th>Region</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
<th>Financing Instrument</th>
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<tbody>
<tr>
<td>SOUTH ASIA</td>
<td>21-Jun-2019</td>
<td>Macroeconomics, Trade and Investment</td>
<td>Development Policy Financing</td>
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<tr>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tbody>
<tr>
<td>Ministry Of Finance</td>
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### Proposed Development Objective(s)

This Development Policy Credit series will support the government in its efforts to (i) strengthen the policy framework to improve fiscal management (Pillar 1) and (ii) enhance policies to promote private sector employment opportunities (Pillar 2).

### Financing (in US$, Millions)

**SUMMARY**

<table>
<thead>
<tr>
<th>Total Financing</th>
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**DETAILS**

<table>
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<tr>
<th>Total World Bank Group Financing</th>
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<tbody>
<tr>
<td>World Bank Lending</td>
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### Decision

The review did authorize the team to appraise and negotiate
B. Introduction and Context

Country Context

1. **The proposed operation is the second in a programmatic series of three operations focused on strengthening the policy framework to improve fiscal management and promote private sector employment opportunities in Bhutan.** Bhutan’s state-led hydropower development has yielded an annual average growth rate of 7.5 percent since the early 1980s. Fiscal revenues from hydropower have helped finance investments in physical and human capital and raised living standards. However, hydropower led development has resulted in macroeconomic vulnerabilities. In addition, the private sector in Bhutan is still at a nascent stage and creates few quality jobs. The creation of more and better jobs (hydropower employs only 1 percent of the labor force) will require a stable macroeconomic environment, enhanced private sector competitiveness, and investments in human capital. Some of these objectives will be supported by this operation through reforms in fiscal and public financial management, improved access to finance, support to e-commerce, and investments in human capital.

2. **Parliamentary elections and the transition to a new government delayed progress on DPC2 but the new government remains committed to the reforms supported by this DPC series.** Bhutan had an interim government from May to October 2018 which was not authorized to undertake key reforms or take strategic decisions. Even after the new government assumed office in November 2018, it took time to settle in and familiarize itself with ongoing initiatives and align them with their own priorities. As a result, progress on DPC2 slowed down and has resulted in some changes to the policy and results matrix and some backloading on reforms. Despite these changes, program development objectives, pillars and reform areas remain relevant. The new government has expressed its firm commitment to the reforms supported by this DPC series and has started making progress on key reforms. The political environment is stable but maintaining reform momentum will be crucial.

3. **Bhutan’s macroeconomic policy framework is adequate for development policy financing.** Despite the delay in completion of the large hydropower projects in recent years, Bhutan’s macroeconomic fundamentals have been sound. Although external debt is high, the intergovernmental contract with India guarantees returns and mitigates risks. Going forward the government remains committed to macro-fiscal prudence as evidenced by its efforts to adopt fiscal rules, implement the GST, improve spending efficiencies through strengthened public financial management (supported by this operation), adopt a debt strategy, and maintain the peg with the Indian rupee. The government is also committed to reforms which will support the non-hydro sectors, many of which are supported by this DPC series (FDI policy, Insolvency Act, credit information bureau, external commercial borrowings and others). Going forward, the key risk stems from further delays in hydropower project implementation / completion, which would also delay the large expected export and revenue payoffs. This risk will partly be mitigated by the strengthening of the tax base, improving PFM systems and the reforms which support the development of the private sector. Going forward it will be important to better manage the flows from the hydropower sector and also widen the production base.

Relationship to CPF

4. **This DPC series underpins all three objectives of the Country Partnership Strategy (FY2015-19).** They include: (a) improving fiscal and spending efficiency; (b) increasing private sector and competitiveness; and (c) supporting green development. The operation is designed to improve spending efficiencies through strengthened PFM and procurement frameworks. It will also support private sector development through improved access to finance, human capital development and greater macroeconomic stability. Green development would be supported through environmentally friendly procurement regulations.
C. Proposed Development Objective(s)

This Development Policy Credit series will support the government in its efforts to (i) strengthen the policy framework to improve fiscal management (Pillar 1) and (ii) enhance policies to promote private sector employment opportunities (Pillar 2).

Key Results

6. **Expected results under pillar 1**: The reforms supported by pillar 1 will help achieve the following results (i) a move towards counter cyclical fiscal policy; (ii) higher domestic revenue mobilization; and (iii) strengthened public financial management and procurement systems.

7. **Expected results under pillar 2**: The reforms supported by pillar 2 will help achieve the following results (i) improvement in the enabling infrastructure (incubators, GIFT) and policies to support sustainable private sector development; (ii) enhanced access to finance; and (iii) improved skills and a boost to human capital.

D. Project Description

8. **The proposed operation is organized under two pillars.** The first pillar supports reforms that will strengthen macroeconomic management, domestic resource mobilization and public financial management. Some of the reforms under this pillar include the establishment of the stabilization fund and adoption of fiscal rules, adoption of the Goods and Services Tax (GST) and improvements in public procurement. The second pillar supports measures which will improve access to finance, facilitate trade and investment and enhance skills and human capital. Reforms under this pillar include strengthening of the credit information bureau, measures to ease Foreign Direct Investment (FDI) restrictions, and improvements in the education and health sector, to strengthen human capital and improve skills. This DPC series also supports the government’s efforts to ensure a sustainable economic growth model by promoting gender equality policies and climate change initiatives. Overall, the operation is designed to have a positive impact on economic growth through a renewed focus on private sector development by promoting macro-economic sustainability and more employment generation. In terms of macro-economic sustainability, supported reforms will help curb revenue volatility and create more fiscal space through greater revenue enhancing policies and improved quality of spending.

9. **The proposed operation primarily supports the government in the first and third areas of the 12th FYP which includes efforts to build a just and sustainable society.** In building a just society, the proposed operation supports improvements in the education and health sectors, and the development of a private sector which will help create jobs and contribute to sustainable poverty reduction. Towards a sustainable society, the proposed operation supports macroeconomic stability, and improvements in nutrition. Among the GNH domains, the operation supports the areas of education, health, good governance and living standards. Reforms supported in the education and health sectors will help strengthen human capital and will have a positive welfare effect. In addition, improvements in public financial management will support good governance. The operation also supports the development of the private sector which will help address, in part, youth unemployment, one of the areas identified for the flagship programs. Many of the reforms will have a positive effect on poverty reduction, in the medium to long term. On the NKRAAs, the first pillar is aligned with NKRA 1 on ‘macroeconomic stability ensured’. The second pillar is aligned with NKRA 2 on ‘economic diversification and productive capacity enhanced’, NKRA 7 on ‘quality of education and skills improved’, NKRA 11 on ‘productive and gainful employment created’ and NKRA 14 on ‘health and caring society enhanced’.
E. Implementation

Institutional and Implementation Arrangements

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

11. The World Bank team works closely with relevant ministries and agencies to monitor progress. This includes the MoF, Ministry of Economic Affairs, GNHC, RMA and other relevant ministries. The MoF monitors progress of fiscal indicators both through their annual budget report and their performance agreement signed with the Prime Minister.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

12. Overall, the policy reforms supported by DPC2 are expected to have positive and neutral effects on poverty reduction. The action linked to improved supervision of the CIB could have an indirect but potentially positive effect on the poor in the long run if it can mitigate insufficient access to finance and contribute to job creation. The adoption of the Non-Formal Education Equivalency Framework would help potential employers evaluate the education credentials of candidates who may have missed the opportunity to pursue formal education but opted for alternative pathways. This policy reform could increase access to jobs among the low-skilled and have a positive impact on poverty. The waiving of the cut-off points for admission into class XI in public and private schools is also likely to have a positive effect on the poor in the long run and will raise the number of years of schooling for them and thereby improve access to jobs. The adoption of the Accelerating Child and Maternal Health Program will also benefit the poor and help them invest in human capital. All other prior actions are expected to have a neutral effect on poverty. Overall, the results suggest that the poverty and social effects will be positive in the medium- to long-term.

Environmental Aspects

13. The proposed operation is likely to have an overall positive effect on the environment. The environmental considerations included in the amended procurement rules could have a potentially positive effect on the environment. The NFE framework could also have a potentially positive effect if environmental issues are reflected in the curriculum for teachers and students. All other prior actions supported by this operation will have no significant effects on the environment.

G. Risks and Mitigation

14. The overall risk rating for this operation is Moderate. Among the risk categories, (i) macroeconomic, (ii) sector strategies and policies, (iii) fiduciary, and (iv) stakeholder risks are deemed moderate, while environmental and social risks are low (Table 6). The political and governance risk, technical design risk and institutional capacity risks are substantial. This is primarily because there is a new government in office which is in power for the first time; there has been
backloading of reforms because of the elections; some of the reforms supported by the operation are complex in nature and the government has weak institutional capacity. Risk mitigation includes strong government ownership of these reforms. In addition, the World Bank’s existing and planned engagements will support reform implementation, focus on capacity development and foster greater coordination across implementing agencies. Close supervision of this operation will help address emerging challenges related to institutional capacity.

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## APPROVAL

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### Approved By

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<thead>
<tr>
<th>Country Director:</th>
<th>Robert J. Saum</th>
<th>21-May-2019</th>
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