



**The World Bank**

Bhutan Second Green and Resilient Growth Development Policy Credit (P178635)

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# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 06-Jul-2023 | Report No: PIDA36009

**BASIC INFORMATION****A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Bhutan	P178635	Bhutan Second Green and Resilient Growth Development Policy Credit (P178635)	P177712
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
SOUTH ASIA	04-Aug-2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
The Kingdom of Bhutan	Ministry of Finance		

**Proposed Development Objective(s)**

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

**Financing (in US\$, Millions)****SUMMARY**

<b>Total Financing</b>	50.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	50.00
World Bank Lending	50.00

## Decision

The review did authorize the team to appraise and negotiate

**B. Introduction and Context**

## Country Context

**Rapid economic growth has contributed to substantial poverty reduction over the last two decades, but vulnerability to poverty and spatial inequality remains high.** Bhutan's economy grew at an average annual rate of 7.2 percent between 2000 and 2019 and its per capita income increased threefold in purchasing power parity terms over the same period. As a result, extreme poverty was almost eliminated in 2017, and the population living below the \$6.85/day poverty line for upper-middle-income countries decreased from 39.7 percent to 8.8 percent between 2017 and 2022.



The COVID-19 pandemic caused major disruptions to economic activity and had a direct impact on production, livelihoods, and worker earnings, resulting in higher poverty incidence. Poverty is more prevalent in rural areas and there are significant disparities across Dzongkhags (districts). While national inequality is lower than the regional average in the South Asia Region, spatial inequality across districts remains an issue.<sup>1</sup> Vulnerability to poverty due to climate-related shocks is high.

**The proposed operation—the second in a programmatic series of two development policy credits (DPCs)—supports the Royal Government of Bhutan's (RGoB) efforts toward resilient and green development.** A more resilient economy with a green and diverse production base can support the COVID-19 recovery and future development, which is in line with the WBG's approach to Green, Resilient and Inclusive Development (GRID).<sup>2</sup> This DPC series is also aligned with the WBG's Global Crisis Response Framework (GCRF) "Navigating Multiple Crisis", underpinned by the GRID approach. The operation builds on the reform program supported under the "Strengthening Fiscal Management and Private Sector Employment Opportunities" DPC series completed in FY20, and the "COVID-19 Crisis Response DPC" completed in FY21.

#### Relationship to CPF

**This DPC series is consistent with the WBG CPF FY21-24 discussed by the Board on January 14, 2021 (Report No. 154927-BT).** Policy actions included in this operation are directly related to the CPF objective of *improved economic resilience* through improving transparency and reducing fiscal risks through better monitoring of public debt and SOE performance; increasing access to international finance to support domestic firm growth; fostering the digital economy and digital literacy that will especially benefit women; and facilitating cross-border trade. And the CPF objective of *improved environmental resilience* through focusing on biotechnology and commercial agriculture to contribute to a shift from conservation to sustainable natural resource management; and monetizing emission reductions to support Bhutan's commitment to remain carbon neutral and financing further mitigation and adaptation objectives.

#### C. Proposed Development Objective(s)

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

##### Key Results

**Results intended to strengthen resilient and private sector-led growth aim at:** i) increasing non-performing loans (NPLs) resolved through out-of-court settlement; (ii) improving access to international finance for the private sector; (iii) improving the reporting and transparency of fiscal risks from state-owned enterprises (SOEs) and public debt; (iv) increasing the number of e-commerce business licenses, including for women; (v) facilitating domestic and international digital payment transactions; and (vi) lowering import tariffs.

**To foster green growth focused on renewable natural resources, this DPC aims to achieve four key results:** (i) increasing the export value of agricultural products; (ii) increasing the share of women registered in farmer groups and cooperatives; (iii) increasing the number of proposals for accessing genetic resources, and (iv) generating emission offsets (carbon credits) from hydropower and other renewable natural resources for their monetization.

#### D. Project Description

**The proposed operation aims to achieve its policy objectives through two pillars, the first of which aims at strengthening resilient and private sector-led growth through fiscal sustainability and enhanced access to finance and markets.** The operation will support the revision of the External Commercial Borrowing (ECB) framework to increase

<sup>1</sup> The Gini index that measures inequality is recorded at 0.29 in 2022 in Bhutan.

<sup>2</sup> "From COVID-19 Crisis Response to Resilient Recovery - Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID)", prepared by the World Bank Group for the virtual April 9, 2021 Development Committee Meeting



access to international finance to support domestic private firm growth, improve transparency and reduce fiscal risks through better monitoring of public debt and SOE performance, strengthen the e-payments framework to facilitate e-commerce and the digital economy, and improve customs rules and regulations to facilitate cross-border trade and increase access to international markets.

**The second pillar of the operation aims at fostering green growth by leveraging Bhutan's natural renewable resources.** Supported reforms include the Food and Nutrition Security (FNS) Policy and the Biodiversity Act and Rules, which are expected to promote the sustainable management of renewable natural resources to unlock their untapped economic potential, while continuing to ensure conservation of renewable natural resources. They will create green and inclusive economic opportunities in remote areas, where many of the poor and vulnerable live. The operation will further support the adoption of Article 6 of the Paris Agreement (Carbon Market Rules) to support Bhutan's access to carbon markets, and to monetize emission reductions from hydropower and other renewable natural resources.

**The proposed operation supports the government's reform agenda.** Actions supported in this operation contribute to the objectives of the 12<sup>th</sup> Five Year Plan (FYP), and the government's focus on economic recovery and growth following the COVID-19 pandemic. Measures under Pillars 1 and 2 are aligned with the 12<sup>th</sup> FYP's objectives of building a *sustainable, just, and harmonious society*. Reforms under Pillar 1 ensure fiscal and financial sector stability through enhanced fiscal risk assessment, SOE oversight, and simplified NPL resolution. Pillar 1 also supports better access to finance and digital solutions as priorities to boost private sector development. These policy actions are expected to support economic diversification, supporting the objectives of two flagship programs under the 12<sup>th</sup> FYP (Digitalizing Bhutan, and Increasing Economic Diversification). Measures under Pillar 2 promote the sustainable utilization of Bhutan's renewable natural resources and biodiversity focusing on commercial agriculture, biotechnology, and monetization of emission reductions.

## E. Implementation

### Institutional and Implementation Arrangements

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

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

### Poverty and Social Impacts

**The proposed operation is expected to have positive poverty and social impacts.** The policies fostering international commercial borrowing and the digital economy are expected to have positive social and distributional impacts, as they can help accelerate private sector development and provide increased job opportunities. While policies to enhance fiscal risk assessment and SOE oversight have a neutral poverty impact, they could improve macro stability and help prevent economic crisis-induced increases in poverty. The FNS Policy is expected to enhance food sustainability and security and promote job creation, thereby contributing to the reduction of malnutrition, and promoting a diversified, balanced, and healthy diets with positive impacts on the health and wellbeing of the population. The Biodiversity Act and Rules will help recognize and protect the rights of rural populations who are more likely to be poor and rely on forests and forest products for their livelihoods. Together with other reforms to harness the economic benefits of sustainable private



forestry and forest-based industries, these measures are likely to be moderately pro-poor. The policy on facilitating Bhutan's access to carbon markets can have a positive impact on poverty if the revenues from the sale of carbon credits are invested in a pro-poor manner.

#### Environmental, Forests, and Other Natural Resource Aspects

**Policies supported by this operation are expected to have either significant positive or no effect on Bhutan's environment, forests, and other natural resources.** The policy to improve customs rules and regulations is expected to have positive effects on the environment. While it facilitates cross-border trade, it also contributes to strengthening border control of restricted and prohibited goods such as forestry products and industrial and toxic wastes. Policies under Pillar 2 promote the sustainable use of renewable natural resources, while ensuring security and sustainability of the food and nutrition system, creating new jobs, and stimulating economic opportunities, especially for the poor. These policies are expected to generate positive environmental effects, as they will contribute to (i) strengthening environmental and natural resources management, particularly for biodiversity conservation and access and benefit sharing (ABS) of genetic resources and associated traditional knowledge, creating new engines for green jobs from Bhutan's natural capital; (ii) improving sustainability and climate resilience in the agriculture sector, and (iii) reducing greenhouse gas emissions and potentially air pollutants if revenues from emission reductions from hydropower and other renewable natural resources are channeled toward additional climate mitigation and adaptation investments.

#### G. Risks and Mitigation

**The overall risk rating is substantial.** The *fiduciary risk is substantial* due to the risks associated with the foreign exchange control environment of the Royal Monetary Authority (RMA). Mitigation measures include a dedicated bank account for the DPC disbursements and its audit, technical assistance from the Bank and other development partners including a review of foreign exchange management internal control at RMA, and future financial audits of the RMA's annual financial statements jointly by an international and a local audit firm from the Royal Audit Authority's list of empaneled audit firms. *Macroeconomic risks* are substantial due to the materialization of financial sector contingent liabilities, additional delays in hydro projects, as well as external risks including high commodity prices and lower tourism demand. Short-term macroeconomic risks are partially mitigated by the government's commitment to ensure macro-financial sustainability. *Stakeholder risks* are substantial as some reforms may face resistance from interest groups, partly mitigated by extensive public consultations and support. *Technical design risks and institutional capacity*, as well as *political risks*, are also substantial in the context of upcoming national elections and recent public staff attrition related to public sector reforms. These are mitigated by strong government ownership of the proposed reforms and continued technical assistance from the World Bank and other development partners.

#### CONTACT POINT

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##### Borrower/Client/Recipient

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**APPROVAL**

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**Approved By**

Country Director:	Abdoulaye Seck	06-Jul-2023
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