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Report No.: 20158 BHU

MEMORANDUM OF THE PRESIDENT  
OF THE  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
TO THE  
EXECUTIVE DIRECTORS  
ON A  
COUNTRY ASSISTANCE STRATEGY  
OF THE  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
FOR  
BHUTAN

FEBRUARY 22, 2000

Bhutan Country Unit  
South Asia Region

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## CURRENCY EQUIVALENTS

Currency Unit	=	Bhutan Ngultrum (Nu)
US\$1	=	Nu 43.40 (February 22, 2000)

## FISCAL YEAR (FY)

July 1 – June 30

## ACRONYMS AND ABBREVIATIONS

AIDS	-	Acquired Immune Deficiency Syndrome
FDI	-	Foreign Direct Investment
GDP	-	Gross Domestic Product
GEF	-	Global Environment Fund
GNP	-	Gross National Product
HIV	-	Human Immune Virus
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
SDR	-	Special Drawing Rights
UNDP	-	United Nations Development Program
UNHCR	-	United Nations High Commissioner for Refugees
UNICEF	-	United Nations Children's Fund

Vice President	:	Mieko Nishimizu
Country Director	:	John W. Wall
Team Leader	:	Peter Nicholas

**BHUTAN**  
**COUNTRY ASSISTANCE STRATEGY**

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**MAP No. IBRD 30467**

# THE INTERNATIONAL DEVELOPMENT ASSOCIATION'S COUNTRY ASSISTANCE STRATEGY FOR BHUTAN

## EXECUTIVE SUMMARY

### **IDA'S MISSION**

1. *IDA's mission is to help Bhutan manage its considerable natural, institutional, cultural, and environmental assets in ways that can translate economic growth into rapid and inclusive social transformation and improvements in living standards.* This is consistent with Bhutan's distinctive vision of its long-term development as it enters the new millennium. This is also a highly selective mission, in order to fit IDA's continuing role as one of Bhutan's smallest foreign aid donors. IDA's comparative advantage—in transferring knowledge and ideas to Bhutan rather than finance—is consistent with our small role in Bhutan, and complements Bhutan's development framework for donor coordination. Emphasizing IDA's comparative advantage in analytical and advisory work—as opposed to lending—also makes sense in terms of gradually filling IDA's information and knowledge gaps resulting from our very limited past involvement in Bhutan. The government fully supports IDA's mission.

### **DEVELOPMENT CHALLENGES**

2. This mission is set against Bhutan's unique characteristics: a small Himalayan nation of about 760,000 people with a 1998 GNP per capita of US \$480; close political and trade relationships with India going back 40 years; large, environmentally benign hydropower assets that are fueling rapid GDP growth through electricity exports and energy-intensive industries such as cement, calcium carbide, and forestry; a comprehensive, well-articulated national vision for development that emphasizes the preservation of Bhutan's cultural and environmental heritage and rising investments in its people; girls accounting for 45 percent of primary school students and social indicators that are improving rapidly; fiscal prudence and a strong balance of payments position; sound public institutions; a participatory style of governance; and a committed administration.

3. But it is also set against Bhutan's difficult terrain and still weak infrastructure, which puts more than half its population at least half a day's walk from the nearest motor road; the heavy reliance on foreign aid and a dominant, single-commodity export; a shallow financial sector that does not yet fully support private sector development; the difficulty of creating private sector employment opportunities, both in rural Bhutan, where much of the population lives, and in rapidly growing cities, where increasingly educated Bhutanese are entering the labor force; the highest population growth rate in South Asia; social tensions arising out of the presence of a Nepali-speaking minority in the south; and economic data deficiencies that may be constraining policy design even though the policymaking process remains highly participatory.

### **BHUTAN'S DISTINCTIVE VISION OF DEVELOPMENT**

4. Bhutan has adopted a balanced approach to development, seeking to calibrate development goals to its ability and readiness to absorb change without creating social alienation or excessive economic inequality. Human development, a living culture and heritage, balanced and equitable development, good governance, and environmental conservation remain the

cornerstones of its recently articulated development vision.<sup>1</sup> This vision reflects the notion of development as social transformation and, in its conception, implementation, and management of donor partnerships, precedes and is fully consistent with the Comprehensive Development Framework. The government has articulated desirable long-term outcomes and detailed milestones to measure progress in each development area (Annex A1). The government is emphasizing its development and poverty reduction strategy of larger investments in the social sectors, a better enabling environment for private sector development, diversification of exports and of the productive base, and improvements in rural infrastructure. The regular and extensive field visits by officials at all levels, combined with the small population size (fewer than 100,000 households), means that the government has a sophisticated and detailed knowledge of conditions and needs across the whole country.

### **BHUTAN'S DEVELOPMENT PARTNERSHIPS**

5. Bhutan differs from most other aid-dependent countries in that the government has a very strong sense of vision and development priorities—and of the comparative advantage of various donors—and determines on this basis where technical and financial assistance is most needed, and which donor can best provide it. The admirably small size of the government means, however, that donor missions can impose a high cost on scarce government officials' time. Bhutan therefore prefers to limit the number of donors overall, and in any particular sector, in order to keep coordination costs low. This approach is fully consistent with the approach espoused by the Comprehensive Development Framework. India is the largest donor. Other important donors include Austria, Denmark, Japan, Netherlands, Switzerland, ADB, European Union, UNDP, and UNICEF. In forestry and education, IDA and Switzerland have been acting effectively as a single donor. The Government, UNDP, and IDA jointly chair the donor Round Table Meetings, the last one in Geneva in 1997. UNDP holds sector-oriented coordination meetings frequently among donors resident in Thimphu, with participation from the non-resident multilateral institutions, as possible.

### **IDA'S ASSISTANCE STRATEGY**

6. IDA's strategic goal is to assist Bhutan—in ways that are driven by Bhutan and in full partnership with other donors—in realizing its development vision. Bhutan's favorable medium-term growth prospects and its comfortable macroeconomic balances, based on its natural resource endowments and substantial grant and concessional aid inflows, create ideal conditions for concerted action to meet its development challenges. Its development vision provides a well-articulated agenda for action that is fully owned by Bhutan.

7. The last country assistance strategy was discussed with the Board in July 1993 and emphasized a limited and highly selective role for IDA focusing on economic policy advice, natural resource management, and primary education. Bhutan has drawn relatively little on IDA financing in the past, preferring to use grant aid from bilateral donors and the UN before using multilateral assistance. This selective role will continue, but will build much more strategically on IDA's comparative advantage in Bhutan in transferring knowledge and ideas rather than finance. As a result of our limited past involvement, there are a number of gaps in our knowledge base in areas such as poverty analysis and public expenditures—the new emphasis on working with the government on analytical and advisory services will help fill these gaps over the next few years and lead to shared learning valuable both to Bhutan and IDA.

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<sup>1</sup> *Bhutan 2020: A Vision for Peace, Prosperity, and Happiness*, Royal Government of Bhutan, Thimphu:1999.

8. In line with this comparative advantage in Bhutan, the locus of IDA's assistance will therefore increasingly be to place its knowledge resources at the disposal of the government without tying them to IDA credits. The government has already requested such knowledge-based consultations on macroeconomic policy, a financial sector strategy, long-term health and education strategies, and accounting and auditing standards. IDA expects to assist with the generation and analysis of poverty data. Other areas in which IDA may assist with knowledge transfers include private sector development, foreign direct investment, trade and investment reform, public expenditures, employment analysis, school curriculums, rural road capacity development, and policy frameworks for economic and sector development. The government is interested in greater harmonization of donor support and in discussing the merits of more program-oriented funding and has asked for IDA's help in thinking through the issues.

9. IDA's limited role in providing financial support for Bhutan's development is likely to continue, with IDA lending only modest amounts under special circumstances when other donors cannot put together a timely package of knowledge, practical expertise, and financing as requested by the government. In line with the previous CAS, past lending has focused on primary education and forestry. As part of our ongoing dialogue, and following the two infrastructure projects accompanying this country assistance strategy, IDA will explore with the government options for financing high-priority projects in social and physical infrastructure and forestry that have a high payoff for improving the living standards of the poor and for private sector development. Such financing could take the form of standard project credits or sector program credits. Given Bhutan's strong record of governance and implementation, economy-wide program credits have also been discussed with the government, to be provided if economic conditions merit such support, and based on prior public expenditure and poverty analysis.

## **RISKS**

10. Bhutan faces two kinds of development risks. First, is the vulnerability arising out of its external environment—the heavy reliance on power exports to India and financial support from India, and, in general, on foreign aid. Relations with India continue to be principled and reflect the long-standing partnership between the two countries, with no emerging problems that would suggest increased vulnerability. The development effectiveness of foreign aid in Bhutan suggests that it will continue to receive aid flows, but Bhutan's large and growing foreign exchange reserves could lead some donors to reallocate aid flows at the margin to other countries. The government's long-term goal is to reduce its reliance on foreign aid. Macroeconomic stability is not itself likely to be much of an issue over the medium term because of the past history of fiscal prudence, a strong balance of payments position with very little debt, and the nominal anchor provided by the currency peg with the Indian rupee.

11. Second, and more important, Bhutan faces the risk of rising social and political tensions from rapid population and economic growth, particularly if economic growth does not yield universal increases in levels of living. What happens to growth will remain a function of how well Bhutan strikes the balance between growth and concerns about the environment and maintaining the integrity of its historical heritage and cultural values. Much will depend on the way Bhutan manages the conversion of economic growth into social transformation, including meaningful employment opportunities for its people. In doing so it will have to manage expectations associated with a 6-7 percent GDP growth rate. In particular, unrest in the south related to Nepali-speaking minorities has attracted considerable attention. The government is

attempting to negotiate a just settlement to the refugee issue together with the Nepalese government. In the east, the incursion into Bhutan of rebels opposing the Indian government in Assam poses risks, but the government is working with the Government of India to contain such incursions.

#### **ISSUES FOR BOARD DISCUSSION**

12. In its discussions, the Board may wish to consider the following:

- IDA's recognition of Bhutan's unique characteristics and its distinctive vision for its development, which seeks to improve the lives and living standards of its citizens in holistic ways without compromising its cultural identity and its environmental heritage.
- IDA's willingness—within a Comprehensive Development Framework and recognizing that IDA is among the smallest donors but also has unique comparative advantages—to support Bhutan first and foremost through knowledge transfers, then through financial assistance as needed. Such a knowledge-intensive strategy will also lead to learning that will fill IDA's information gaps on Bhutan.
- IDA's continuing support to Bhutan in building its social and physical infrastructure as ways of converting its rapid economic growth into inclusive social transformation.

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FOR BHUTAN**

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1. Bhutan is a landlocked Himalayan country with a 1998 population of about 760,000, wedged between the world's two most populous countries, India and China. With altitudes varying from 100 to 7,000 meters (within a south-to-north distance of less than 100 kilometers), Bhutan has almost every micro climate of the world and much rugged terrain. Its 1998 per capita GNP was US\$480. Bhutan has many factors in its favor. Rich in natural resources, including large, environmentally benign hydropower assets, it has a ready market for electricity and resource-based exports to India. Its public administration of dedicated professionals, headed on a rotating basis by a member of the Cabinet, has a clear vision for Bhutan's future based on extensive consultations with the people and elected representatives at all levels of society. Few Bhutanese are hungry, landless, or homeless, although there have been no comprehensive living standards surveys to provide accurate assessments of rural and urban poverty and changes over time. There is relatively little gender discrimination—girls make up almost half of primary school children, women constitute a substantial proportion of new civil servants, and inheritance is matrilineal in many areas. Bhutan was one of the first countries to start protecting its environment and culture; over 70 percent of the country is under forest cover, and tourism is limited to sustainable levels.

2. But despite impressive development gains over the past 30 years, Bhutan faces the many development problems of a low-income country. Its fundamental challenge is to translate rapid economic growth into inclusive social transformation and improvements in the living standards of its people, and to do so without compromising its cultural identity and environmental heritage, to which it attaches great value. Perhaps as much as half the population lives in remote areas without access roads, electricity, piped water, or telephones, and far from schools, health clinics, markets, and public transportation. Eighty-five percent of the population is rural, and agriculture accounts for 38 percent of GDP. It has a nascent modern private sector and a still-shallow financial sector. It will take time for the private sector to lead growth and generate substantial employment. Though the government relies on highly participatory modes of policymaking at all levels of society, development and economic statistics are limited and not always reliable.

**A. POLITICAL, ECONOMIC, AND SOCIAL CONTEXT**

**Dedicated, Professional Political Leadership**

3. As part of a decade long process of political transformation, Bhutan introduced far-reaching political changes in 1998, when the entire cabinet was asked to resign and a new six-member cabinet was selected from among high-achieving civil servants. The King is no longer the head of government, a post now held on a rotating basis by a Cabinet member. Cabinet

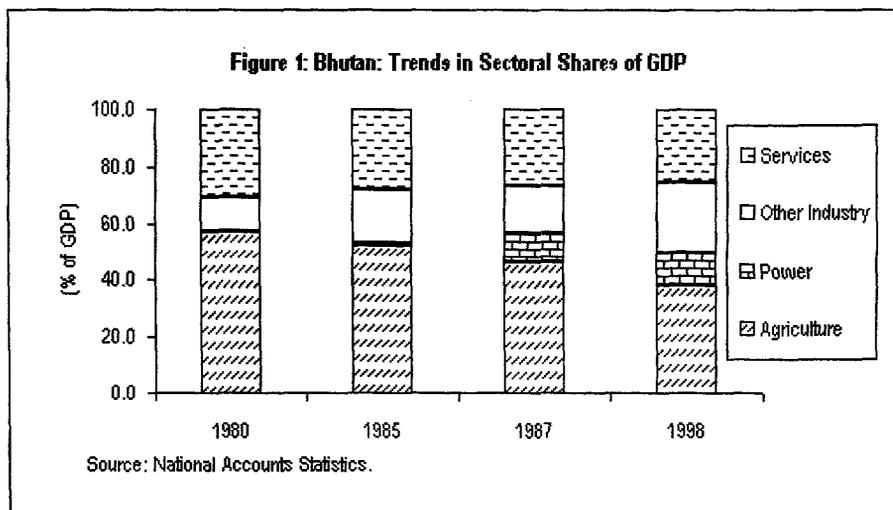
members were approved by secret ballot by Bhutan's elected body, the National Assembly. New Cabinet elections are to be held every five years, and the Assembly is elected every three years.

4. Bhutan's government is dedicated, professional, and honest. Decision-making and budget authority have been increasingly decentralized. Civil servants are well paid relative to their counterparts in the private sector—recent pay increases have largely corrected the slippage of past years. The increasing use of private sector bidders on government contracts has led to some minor corruption, to which the government has responded rapidly by strengthening the Audit Authority. The government has also rededicated itself to preventing misuse of public funds, with officials held accountable for actions that might go unremarked in many other countries.

### Rapid, Resource-led Growth

5. Bhutan's development has been rapid. Until the 1950s, Bhutan isolated itself from the rest of the world, and its dispersed rural population depended on subsistence agriculture. Once it opened to the outside world in the 1960s, Bhutan embarked on a far-reaching development strategy that has been articulated in eight Five-Year Plans. Bhutan has developed a physical infrastructure of roads,

power supply, telecommunications, and water supply that now serves a rapidly increasing share of the population. At the same time the government has developed a social infrastructure of education and health services that, despite the difficult terrain and scattered population, has greatly improved access.



6. Agriculture continues to account for the largest share of GDP (38 percent in 1998, Figure 1). Hydropower (11 percent of GDP) and foreign aid (23 percent of GDP) are important elements in Bhutan's small economy (1998 GDP of US\$428 million). Its average GDP growth rate of almost 7 percent a year since 1985 has been propelled by the 370 MW Chukha hydropower project, which has boosted GDP growth directly through power exports to India and by facilitating energy-intensive industries such as cement, ferro-alloys, and calcium carbide.

### Benign External Environment

7. The Bhutanese economy is closely linked to India. The Indian rupee circulates in Bhutan as legal tender. Bhutan's free access to the vast Indian market (India's GDP is almost a thousand times larger than Bhutan's) and almost unlimited demand for hydropower have boosted Bhutan's

exports. Bhutan's large trade deficit with India has been financed by Indian grant aid. India has also financed Bhutan's major hydropower projects and some of its large industrial investments. Beside India, other donors have also been generous in giving aid to Bhutan. Between 1993 and 1998 Bhutan annually received an average of about US\$80 million in disbursements of concessional assistance. Of this 85 percent was grant aid, with external borrowings limited by the government's policy of first using grants. The highly favorable terms of its aid, combined with efficient, cost-effective, and transparent use, has enabled Bhutan to limit its external debt. Its 1998 ratio of debt service to exports was under 7 percent.

### **Strong Social Development, but Rising Challenges**

8. **Poverty and Social Indicators.** While few Bhutanese are hungry or homeless, the government is deeply concerned about the presence of seasonal hunger, food insecurity, and exclusion of groups living in remote and marginal areas (see Box 1). Even though policymakers themselves engage in an unusually high degree of consultation starting at the village level, Bhutan does not have good poverty statistics that could better inform policy choices on poverty programs. It needs to carry out a living standards survey to provide a firm basis for analyzing living standards and income distribution in both urban and remote areas, with periodic and selective poverty monitoring thereafter. While there are no direct measures of poverty incidence, social indicators themselves reveal an impressive advance (even allowing for data deficiencies in earlier years). Mortality and education indicators are relatively good, especially given Bhutan's scattered and remote population, and life expectancy at birth is substantially above the South Asian average (Table 1). The provision of more rural access roads is part of the government's poverty reduction strategy. The government is also working on targeted programs for eastern Bhutan, where soils tend to be poorer and population densities higher.

#### **Box 1: Bhutan's Vision of Inclusion**

*In May 1999, the Royal Government produced a comprehensive statement of Bhutan's future as it enters the next millennium, Bhutan 2020: A Vision for Peace, Prosperity and Happiness. On inclusion, Bhutan 2020 notes:*

Although the vast majority of our population have benefited in very tangible ways from the process of social and economic development, the benefits have not been shared equally. This is an inevitable consequence of modernization in a country in which the population is so scattered, the terrain so severe, and infrastructure still incomplete. Despite the rapid expansion of the road network, more than half of our population lives more than half a day's walk from the nearest motor road, while in more isolated and remote areas communities are still dependent on trails, muletracks and ropeways for communication. ...

In these remote and isolated areas lives are still characterized by vulnerability and uncertainty and by the sheer drudgery of toil from dawn to dusk in order to satisfy daily survival needs. Food shortage of some three months, coinciding with planting seasons, are not uncommon in a few *dzongkhags* (districts), while in isolated pockets within them food insecurity is more severe and malnutrition widespread. Although free basic education and health care are today reaching these pockets of disadvantaged and vulnerable groups, the need to contribute to the construction and maintenance of buildings, the cost of travel, contributions to school welfare funds, the cost of school uniforms and so forth, while modest, are sufficient to place the services beyond the reach of the poorest farmers and their families. . . . Ensuring that disadvantaged and vulnerable groups are able to benefit more fully from the process of social and economic development is a challenge that must be met in the years ahead.

Source: *Bhutan 2020: A Vision of Peace, Prosperity, and Happiness*, Royal Government of Bhutan, May 1999.

9. Within South Asia itself, Bhutan is still catching up with most other countries. In the mid-1970s, Bhutan's social indicators were the lowest of any country in South Asia. Now, 25 years later, they are roughly comparable to the regional averages, with the exception of its higher fertility and population growth rates. Globally, UNDP ranked Bhutan 145th among 174 countries in 1997 on its Human Development Index.

10. With the continuation of the right policies and expenditure priorities, and given the country's resources and capacity, Bhutan should be able to raise social indicators substantially. However, Bhutan's rapid population growth rate—estimated on average at 2.9 percent a year for 1995–2000 and higher than in India, Bangladesh, and Sri Lanka—makes the improvement in social indicators a challenge. Finding employment for its young and increasingly educated labor force is also a challenge. The government is correctly determined not to become the employer of first and last resort. The modern private sector is not developed enough to absorb the rapidly growing labor force. This is a challenge for which there is no easy solution, given the difficulty of finding labor-using private sector activities that can compete with Indian goods.

Table 1: Bhutan: Development Indicators

	1970s	1998 1/	South Asia	Low-Income
Total population (million)	0.44	0.76	1305	3515
Growth rate (% annual average)	1.4	2.9	1.8	1.7
Urban population (% of total)	3.5	15	27.0	31.0
Total fertility rate (births per woman)	..	5.8	3.5	3.2
Life expectancy at birth (years)	46	66	62	63
Infant mortality (per 1,000 live births)	142	71	77	69
Maternal mortality (per 1,000 live births)	7.7	3.8	..	..
Adult literacy rate (%)	28	54	51	68
Gross primary school enrollment (%)	35	72	100	108
Roads (km)	1,755	3,440		
Electricity connections	9,750	29,700		
Rural water supply schemes	150	1,760		
Telephones	1,880	9,314		

Source: Royal Government of Bhutan & World Bank.

1/ When not available, most recent data shown. Pop. based on 1990 Census of 600,110. Data for S. Asia and low-income countries are most recent available.

11. **Ethnic Unrest and Threats to Social Stability.** The government is working to create a fair society in which all nationals can benefit equally from the fruits of Bhutan's development. But Bhutan, like most multi-ethnic societies, has experienced social tension. In the 1980s concern arose about the ambitions of some among the Nepali-speaking minority inside Bhutan (mainly in southern Bhutan, where the majority of Nepali speakers live) and activists outside Bhutan. The government began enforcing its citizenship laws and moved to solidify national cultural convergence. Unrest emerged in the south in the late 1980s, and the ensuing violence led to refugee camps springing up in Nepal. While some of the refugees are former inhabitants of Bhutan (illegal immigrants or not), some are said to be Nepalese who had never resided in Bhutan. The government has been actively seeking solutions through discussions with the Government of Nepal and the United Nations High Commissioner for Refugees, and is working with Amnesty International. A more recent threat is the incursions into eastern Bhutan of Bodos and members of the United Liberation Front of Assam (insurgents opposing the Indian

government in Assam). These insurgents are using the dense forests in the area as safe havens. The government is working with the Government of India to contain this threat to Bhutan's stability.

## B. RECENT ECONOMIC DEVELOPMENTS AND KEY CHALLENGES

### Resource-based Growth

12. Real GDP grew by about 6 percent in 1998-99, boosted by investments in hydropower and by power exports. Three medium- to large-scale hydroelectric projects are under construction, including the 1,020 MW Tala project (Box 2). These projects, all run-of-the-river, are environmentally and socially benign, requiring no large storage reservoirs. Bhutan's medium-term economic prospects are good, with a major economic boost expected in 2004 when Tala comes on-stream, and with smaller jumps expected in 2001 and 2002 when the 45 MW Kurichu and 60 MW Basochu projects come on-stream. These projects will raise the proportion of power in GDP to about 30 percent from its current 11 percent. India is reforming its power sector and moving to a more market-oriented approach. This is likely to lead to greater price differentials depending on when and with what reliability electricity is supplied. Over the long run, Bhutan's export power tariffs will need to be competitive with those of other Indian suppliers, while still continuing to provide adequate royalties for the use of its water resources and for servicing debt.

#### Box 2: Bhutan: Hydroelectric Power Projects

- **Chukha.** The largest power project commissioned so far, Chukha was completed in 1988 with an installed capacity of 336 MW, subsequently increased in 1997 to 370 MW. The project cost of US\$255 million was financed by the Indian government through concessionary loans (40 percent) and grants (60 percent). Eighty-four percent of Chukha's cumulative generation since commissioning had been exported to India as of February 1999, with a corresponding revenue from sale of power of \$170 million. According to the initial agreement between Bhutan and India, electricity tariffs were to be revised every four years, but these have been reviewed more frequently in view of escalating maintenance costs since the tariff was first set at 1.9 US cents (Nu 0.27) per kWh in 1988. The last tariff was set in June 1999 at 3.5 US cents (Nu 1.5) per kWh.
- **Basochu.** Construction of the Basochu project started in 1998 and is expected to be completed by the end of 2001. The combined peak capacity of Basochu will be 60.8 MW. The generated capacity will meet domestic demand of 11 districts in the west-central region of Bhutan. The project cost, estimated at US \$37 million, is being financed by concessionary loans and grants provided by the Austrian government.
- **Kurichu.** Construction of the 45 MW Kurichu project began in 1995 with an estimated cost of US\$89 million. It is expected to be fully commissioned by September 2001. The project is financed by the Indian government on a 60 percent grant and 40 percent concessional loan basis. Additional financing for a fourth generating unit to increase the installed capacity to 60 MW is being considered by the Indian government. The installed capacity of the project will meet the domestic demand of the eastern region of Bhutan. The project is also expected to provide power to the Dungsum Cement Project in eastern Bhutan.
- **Tala.** Construction of the 1020 MW Tala project began in 1998 and will be the largest power plant when it is completed in 2004. Tala, estimated to cost about US\$727 million, is being financed by the Indian government on a 60 percent grant and 40 percent concessionary loan basis. The generated capacity will be mainly exported to India under a power purchase agreement signed in 1996.

### **Heavy Reliance on Foreign Assistance**

13. Foreign assistance, mostly in the form of grant aid, is likely to continue at present rates at least over the medium term. Rupee debt is expected to increase over the next few years from borrowings for the Tala and Kurichu power projects. The 50 percent increase in the power export tariff to India in 1999 should, however, more than compensate for the increased debt service. There are many signs of the impact of these large inflows of resources: a high domestic saving rate (38 percent of GDP), high foreign exchange reserves, budget surpluses, and a high proportion of domestic financial assets in the form of foreign assets (80 percent foreign, of which 80 percent are in hard currency).

### **Sound Public Expenditure Management**

14. Bhutan has a strong record of public expenditure management. The overall budget (after grants and concessional credits) has always been close to balance, with just a small surplus or deficit. Bhutan's attention to quality and development effectiveness has meant year-on-year slippages in capital expenditures, with actual capital expenditures tending to undershoot annual budgets, but coming in close to plan over the entire five-year plan period. Recurrent expenditures have tended in aggregate to be slightly above plan and budget, with health expenditures having proportionately the largest overrun. But conservative forecasting of revenues has avoided sustained budget deficits. It has also allowed the government to ensure that recurrent expenditures are domestically financed, which is crucial for ensuring the sustainability of the development program—the government has always closely considered the recurrent cost implications of new capital expenditures to make sure that they can be financed without recourse to excessive deficit financing. The government recently raised domestic power prices and introduced user charges for domestic water and school materials. It is considering establishing a personal income tax. Over the longer run, Bhutan needs to diversify its revenue base.

### **Dutch Disease, the Private Sector, and Employment**

15. Bhutan's economy is both blessed and burdened by the richness of its natural resources and the large volume of donor aid it attracts. The large inflow of foreign aid and of foreign resources produced not by the competitiveness of domestic production and diversified exports but by hydroelectric power exports that are large relative to the total economy, has created a peculiar strain of "Dutch disease." And because Bhutan's exchange rate is pegged at parity to the Indian rupee, the exchange rate does not work as a mechanism for lowering the prices of tradables relative to nontradables. Instead, the real exchange rate appreciates, making imports more attractive and exports less attractive. This has undermined the domestic competitiveness of non-power exports and discouraged them. The effect is also seen in the high wages of Bhutanese farm and unskilled workers (several times the wages of similar workers in India) and low labor absorption (and therefore employment).

16. This Dutch disease syndrome is limiting the development of a diversified, employment-intensive economy and may become a more serious concern when the massive Tala hydropower project comes on-stream in the next decade. These forces have been dampened somewhat by

Bhutan's high savings rate, rising investment in basic social and physical infrastructure, and a lean but effective government. But the population growth rate is high, and the modern sector is still small. Together with the rapid rise in education levels, this suggests that finding employment opportunities for an expanding and increasingly educated labor force will be a serious problem.

17. There is no easy cure for Bhutan's Dutch disease-like problem. One approach is to invest the inflows in cost-reducing infrastructure (roads, communication networks), as some countries did to absorb the sudden increase in oil income in the 1980s. Another is to invest surplus resources abroad to create a sustainable income flow, as some countries in the Middle East did in the 1980s. Besides investing in social and physical infrastructure, Bhutan's approach is to focus on strengthening the enabling environment for its still-nascent private sector. The government is gradually reducing its own role in commercially viable areas of the economy, privatizing many public sector corporations and encouraging the private sector to compete in areas that were previously the reserve of the public sector.

18. In this effort, Bhutan needs to avoid the common mistake of other resource-rich countries, which was to subsidize the domestic production of manufactured items that are inherently noncompetitive internationally. Bhutan seems to be heeding this caution and has a long-term goal of creating high knowledge-content service industries (advanced medical care, high quality education, financial and banking services, medicinal drugs) that can serve nearby international markets and sustain high salaries. This strategy will require very high and sustained investments in health and education. Bhutan is already investing public resources in basic physical and social infrastructure (roads, communications, basic health and education) and focusing on high technology (digital telecommunications system, Internet and intranet services, computerization of information flows, and higher education abroad for technical and engineering students).

### **Need for Trade Diversification**

19. India, with which Bhutan has a free trade agreement, accounts for 85 percent of Bhutan's external trade. Bhutan also has transit agreements with India for trade with Bangladesh and the rest of the world. Most of that trade goes through Calcutta port, 600 miles away. The potential for export through Bangladesh is being explored. Major shifts in the pattern of trade are unlikely in the next few years. Bhutan's trade regime continues to favor exports to India. In addition, transport costs, domestic human and capital resource constraints, and a nascent private and financial sector limit the scope of major third-country export industries.

20. Recently, tariffs on third-country imports have been reduced from a maximum of 100 percent to 30 percent and in some cases to zero. Further reductions are constrained by concerns over re-exports to India, which also led to the imposition in 1997 of the Bhutan sales tax on all third-country imports. Quantitative restrictions and other forms of non-tariff barriers are being significantly reduced. Import licensing procedures for third-country goods have been streamlined to allow for greater diversity and competition in meeting the demand for consumer and capital good imports. Imports from third countries are likely to rise faster than exports as a consequence of this liberalization and of rising incomes. High levels of mostly hard-currency foreign assistance more than cover the current account deficit with third countries, but if assistance levels decline the need for export diversification will grow more urgent.

## **Continuing Importance of Agriculture and Rural Development**

21. Bhutan is a mountainous country with limited arable land (8 percent of area) and a large number of terrains, micro climates, and soil types. With 85 percent of the population in rural areas, 38 percent of GDP in agricultural production, and poor transport facilities, rural development is a daunting but crucial goal for the government.

22. Bhutan is well-positioned relative to the Indian plains and has the climates to produce agricultural products in India's off seasons. Bhutan also has free and ready export access to the huge Indian market, the only country in the world with this advantage. With its climate, remoteness, and high wage labor, Bhutan's clear comparative advantage in the future lies in high value crops and high technology agriculture to supply the Bhutanese and Indian markets, and possibly beyond. For the present, however, there is little option but to continue the low input-low output agriculture currently practiced. Scattered rural communities, very difficult and high-cost transport, and traditional farming practices force the production of cereals and dairy products for home consumption and local sale. Both crop and livestock agriculture have low yields, with little fertilizer use on fields and low efficiency animals. There are also some policy obstacles to change, including the law banning conversion of paddy fields to other production.

23. Despite the obstacles, there has already been some movement away from these low productivity practices. Some farmers have already seen the profits from producing potatoes for domestic and Indian markets. These could well be followed with off-season supplies of other basics—tomatoes, ginger, onions, cabbage, and a wide range of other horticulture crops. Bhutan could also increase farm incomes even further with the use of greenhouse technology that maximizes returns to land and labor and access to niche markets.

24. Meeting this challenge of rural development rests on the achievement of an interconnected rural sector in which communities are well-served with roads, electricity, schools, health facilities, trucks, banks and good government. Bhutan needs to increase basic investment in public physical and social infrastructure to channel the benefits of its foreign inflows to its poorer and more remote communities and households.

## **C. BHUTAN'S VISION FOR SOCIAL TRANSFORMATION**

25. In May 1999, the government produced a seminal and comprehensive vision statement of Bhutan's future as it enters the next millennium, *Bhutan 2020: A Vision for Peace, Prosperity and Happiness*. This 20-year vision is remarkable both for its candor and for the clarity with which it analyzes and makes choices on Bhutan's distinctive path of development. Annex A1 shows the concrete milestones under the five topics put forward by *Bhutan 2020* as contributing to increasing Bhutan's "Gross National Happiness" (Box 3). Bhutan's desire to lead development with this strong vision sets the context for IDA's country assistance strategy and is therefore discussed in some detail here.

**Box 3: Bhutan 2020**

Bhutan recently articulated a clear vision and set of values in *Bhutan 2020: A Vision for Peace, Prosperity and Happiness*. Vision 2020 seeks a "cautious interpretation of modernisation." It puts human happiness, not economic growth, at the center of the nation's vision and values for development:

"Our guiding principles for the future development of our nation and for the safeguarding of our sovereignty and security as a nation-state must be complemented by a single unifying concept of development, ...the distinctively Bhutanese concept of Gross National Happiness. .... The concept places the individual at the center of all development efforts and it recognizes that the individual has material, spiritual and emotional needs. It asserts that development cannot and should not be defined exclusively in material terms. ... The concept of Gross National Happiness must be translated into objectives that are able to give direction to the Kingdom's long-term development."

*Bhutan 2020* articulates five development objectives:

- **Human Development**, to enable all Bhutanese to achieve their full potential as human beings. It stresses the need to provide expanded choices and opportunities consistent with the greater self-reliance of the nation and of individuals, families, and communities.
- **Cultural Development**, to promote awareness of Bhutan's rich cultural heritage and its role in meeting spiritual and emotional needs, maintaining a distinctive identity, and cushioning some of the negative effects of modernization.
- **Balanced and Equitable Development**, to ensure that the benefits of modernization are shared equitably by different income groups and regions and in ways that promote social harmony, stability, and unity and contribute to the development of a just and compassionate society.
- **Institutional Development**, to develop institutions, human resources, and governance systems that allow Bhutan to reduce its dependence on aid, to manage an increasingly complex system of development, and to enlarge opportunities for all people to participate in decisionmaking.
- **Environmentally Sustainable Development**, to see that development embodies the principle of environmental sustainability and protects Bhutan's globally significant biodiversity and natural environment.

The Vision is explicit that, in achieving these objectives, Bhutan will have to:

"... take the good with the bad. We have opened the doors to [a globalizing world] and we are no longer able to close them, even if we wanted to. ... The challenge is to find and strike the right balance ... to maximize gains while minimizing ... disruptive impacts. This will be an immensely difficult task, but we are not without tangible assets. Our beliefs and values, so deeply rooted in the perceptions and behavior of our people, provide us with the prisms through which we will continue to interpret the world and to distinguish between positive and negative forces of change."

26. The essential development challenge for Bhutan is to convert its rapid economic growth into effective social transformation, while maintaining its cultural identity and traditions of equality and dealing with an inadequate supply of jobs for the growing, high-wage labor force. *Bhutan 2020* sees the private sector—including knowledge-intensive industries—as the driving force behind employment growth. Bhutan is working to improve the business environment by reforming the financial sector, reducing trade and investment barriers, and keeping the government compact and efficient. This is a vision for the long term, however. For the shorter term, given the conditions of human and physical development, and the large portion of the

population still dependent on agriculture, this sector will have to absorb the bulk of the rapidly growing labor force.

### **Economic Reforms for Private Sector-led Growth**

27. **Private Sector Development.** A strong private sector is crucial to the balanced growth of the economy. The government is committed to reducing, as rapidly as feasible, its role in the productive economy and focusing on the provision of basic infrastructure and social services. Majority ownership and management in seven public sector enterprises (constituting 25 percent of manufacturing/non-government services) have been transferred to the private sector, and other public enterprises have been corporatized. The government has privatized bus services and corporatized postal services. The only non-performing public enterprise has been liquidated after the failure of an initial attempt to revitalize it through privatization. There are plans to privatize some agricultural services, to contract out much power construction and road maintenance, and to encourage private sector participation in education and health. However, the limited absorptive capacity of the local market for equity constrains progress on these initiatives.

28. The government is also taking a number of steps to improve the enabling environment for private sector investment, including:

- Introduction of a transparent framework for direct foreign investment to replace the current restrictive case-by-case approach;
- Issuance of more work permits to expatriate labor;
- Establishment of a transparent set of rules and regulations governing trade and payments with countries other than India;
- Provision of foreign exchange for all bona fide external current account transactions;
- A more active role for the Royal Monetary Authority in using market-based instruments to improve liquidity management;
- Improvements in the legal framework for loan recovery and settlement of financial disputes.

29. **The Financial Sector.** There is considerable excess liquidity in the banking system, most of it sitting in non-interest bearing accounts with the Royal Monetary Authority. This has undermined the profitability of Bhutan's four main financial institutions, which are prohibited from investing abroad (except in short-term instruments of the Reserve Bank of India). Part of the problem has been a boom and bust cycle, with overly enthusiastic lending for enterprises, especially in the tourism sector, that proved not to be viable. The response was a significantly more conservative lending strategy and a sharp reduction in new lending. The imbalance between liquidity and productive lending opportunities will likely continue until Bhutan can break through into much higher value-added economic activities involving the private sector.

30. The government has started to liberalize the financial sector. The competitiveness of the banking system was improved significantly with the conversion of the Unit Trust of Bhutan into a fully fledged commercial bank (in which Citibank has an equity stake) and with the liberalization of interest rates on loans and large deposits. (This has not changed the interest rate structure in practice, however. Deposit rates range from 5 to 11 percent and lending rates from 13 to 16 percent.) The government is also tightening regulation of the financial sector, in

response to the threat of a rapid increase in the number of nonperforming loans. All financial institutions are required to maintain a capital-adequacy ratio above 6 percent, to provision for nonperforming loans, and to maintain a minimum liquidity ratio. The Royal Monetary Authority conducts on-site inspections of financial institutions at least every six months. Clear bankruptcy procedures have been established, and banks now have the right to seize personal property when loans are in default. A Loan Recovery Committee has reduced the nonperforming loans of financial institutions. A computerized stock exchange has been established to encourage equity investments. The Royal Monetary Authority plans to conduct a detailed study of the financial sector and to draft a comprehensive strategy.

### **Strengthening Infrastructure**

31. Aside from the massive investment in the Tala hydropower project and the two other smaller hydropower projects, the government's infrastructure priorities are urban planning and development—Bhutan's major towns are growing rapidly—and road maintenance and improvement. Urban development programs are being prepared for Bhutan's rapidly growing cities, including new urban housing sites. The emphasis for roads is on increasing private participation in maintenance and construction, shortening road connections, making road design and construction more environmentally safe, and expanding the country's still incomplete infrastructure, especially to remote areas.

### **Defining a Future for Agriculture and Forests**

32. Agriculture has traditionally been the principal source of income for most Bhutanese families and is still the largest area of private sector production. Approximately 85 percent of the population is engaged in farming or forestry, which account for 38 percent of GDP.

33. Under the Eighth Plan (1997-2002) the government is moving away from its unsuccessful emphasis on large capital investments toward a program framework approach. Agricultural activities will be managed under six discrete programs: development of farm systems, crop and livestock production, forest management, horticulture exports, planning and management, and training. Bhutan is diversifying into new export crops and emphasizing domestic production of nontraditional crops such as potatoes. Community involvement and cost-sharing are increasing, especially for irrigation. Irrigation schemes for cash crops will be fully financed by the farming communities, with the government providing only technical advice.

34. The government's role in forestry is fundamentally different from its role in much of the rest of the rural economy, where production is in private hands. Almost all forests are state-owned. The government sees itself as the custodian of an asset of national significance for maintaining sustainable rural livelihoods and of global significance for biodiversity protection. Forest cover has increased from 60 to 70 percent over the last 20 years—despite heavy subsidies on forest products—because of strict enforcement of controls on encroachment on forest lands and other damaging practices.

35. Fearing a reversal of this trend, and in the interests of economic efficiency, the government is reducing its heavy subsidies on wood for urban and industrial users. Rural users, however, will retain free access to restricted quantities of wood, in line with the government's policy of containing rural to urban migration, and to prevent an upsurge in uncontrolled and

environmentally damaging illegal felling. The government has recently banned exports of round wood and timber in an attempt to increase domestic supply.

### **Balancing Development: Human Development, the Environment, and Culture**

36. **Education.** Bhutan introduced modern secular education in 1961. Since then, it has made enormous progress in building a public primary and secondary education system and, to a more limited extent, in providing selective tertiary schooling. Primary enrollment, which has been increasing at an annual rate of 8 percent in recent years, is now over 70 percent. Bhutan has also emphasized the quality of learning outcomes while raising enrollments. English is the medium of instruction in schools and serves to unify Bhutan's multiple linguistic groups.

37. The government will devote its efforts to achieving universal primary education by early next century and to expanding secondary education to meet rapidly growing demand. The majority of students will continue to receive tertiary education abroad, principally in India. Bhutan has also been gradually increasing the capacity of its own degree granting institutions, where it is cost effective to do so, and is actively developing its strategy for higher education in line with its longer term objectives for growth and development.

38. **Health.** The introduction of modern health services in the 1960s has probably done more than any other program to enhance the quality of life in Bhutan. The country has made remarkable progress in establishing a four-tier health delivery system that is able to deliver health services effectively to its people. There is very little private provision of health services outside of urban areas, since the public provision of health services is effective and health clinics are well stocked and managed (average annual public health expenditures were \$18 per capita in 1997, slightly above the South Asian average of US\$16).

39. Bhutan's high population growth rate, estimated to be about 2.9 percent a year, remains a matter of concern. Reducing the population growth rate is a top priority, and the Eighth Plan has a strong focus on reproductive health and family planning. The government also plans to consolidate and strengthen health infrastructure; improve staffing and service quality, including greater attention to traditional medicine and mental health; and increase access to health care in remote areas. The government has also been conducting a wide-ranging public information campaign on HIV/AIDS prevention. HIV/AIDS prevention will remain high on the government's agenda, including attention to capacity building for an effective national public health program and intensified health promotion interventions targeting vulnerable groups and border areas in the south. For the sector as a whole, capital investments will focus on upgrading basic health units and improving the health delivery system. The Eighth Plan calls for a 50 percent increase in the number of doctors, a 47 percent increase in the number of basic health workers, and a 40 percent increase in the number of technicians. Some degree of cost-recovery is under active consideration, both to raise revenues and to control the excess demand that a free good generates.

40. **Environment and Culture.** Bhutan has been well ahead of much of the world in recognizing the importance of environmental protection. It also places a high value on maintaining its cultural identity, emphasizing its living culture rather than a culture preserved only in museums. The strength of its commitment—and its willingness to sacrifice short-term gains in growth to achieve it—is shown by the 10-percentage point increase in forest cover in the last 20 years and by the control of tourism using a substantial tourist fee. Bhutan's commitment

to the environment is embodied in its Trust Fund for Environmental Conservation, established with support from the Global Environment Facility and other donors. Income from the Trust Fund is used to support the commitment to preserving 23 percent of the land area as wildlife parks and sanctuaries and 60 percent of the land under forest cover. A similar Trust Fund is being established for maintaining its cultural heritage, and the government is soliciting donor support.

#### **D. IDA'S ROLE IN BHUTAN'S DEVELOPMENT**

41. Bhutan has drawn relatively little on the World Bank Group. IDA is almost the smallest donor in Bhutan in terms of resource transfers. IDA commitments over the past 10 years through fiscal 1999 have been only \$19 million, with disbursements of \$12 million. In the past five years IDA has provided only 1 to 2 percent of total aid disbursements. This follows from Bhutan's external aid policy of limiting the number of donors overall and in any sector and of drawing on bilateral grant aid first, followed by UN agencies for technical assistance, and only then turning to international financial institutions. The policy is part of an effort to reduce the transaction costs of dealing with donors. Bhutan is not a member of IFC or MIGA.

##### **Past IDA Support**

42. IDA has been assisting Bhutan very selectively since the early 1980s, initially with support for institution building and calcium carbide production. The last CAS was discussed with the Board in July 1993 and emphasized economic policy advice, education, and forestry. During the early 1990s, Bhutan made good use of IDA's expertise in primary education and forestry and in preparing an economic report and a Power Development Master Plan. IDA has also managed a Global Environment Fund grant and supervised a GEF trust fund for national forest protection. For the most part IDA has provided such support only when other donors could not put together a timely combination of knowledge, expertise, and financing as requested by the government. Bhutan's management of these projects overall has been superior, with good impact and relatively few implementation problems.

43. OED has reviewed Bhutan five projects since 1991. All five were rated satisfactory. Three were rated as having a substantial impact, and the other two a modest impact. None of the projects was judged unlikely to be sustainable, but for three sustainability was judged to be uncertain. Borrower performance was judged satisfactory in all five, and IDA performance likewise, with the exception of the supervision of the second forestry project. IDA's past involvement has led to a few lessons. What appears to have worked well is project impact. An important lesson in project design and implementation is the need to work closely with the government in assessing the availability of technical and managerial staff for project work and supervision. Finally, the experience suggests a larger role for knowledge transfer independently of project lending.

44. In 1997, Bhutan requested IDA to support the adoption of new approaches to rural access roads and small town infrastructure. This has led to the projects that accompany this CAS. This request also led to a deeper dialogue between IDA and the government on Bhutan's development strategy and framework. This country assistance strategy is an outcome of this dialogue.

## IDA's Assistance Strategy

45. IDA's strategic goal is to assist Bhutan—in ways that are driven by Bhutan and in partnership with other donors—in realizing its development vision of translating rapid economic growth into social transformation and poverty reduction. IDA's strategy is set against Bhutan's favorable medium-term growth prospects, its comfortable macroeconomic balances, and considerable exports and aid inflows. The strategy is also set against a development vision that reflects a well-articulated, nationally owned development framework. Bhutan is unusual in South Asia in that its public administration is strong, corruption is low, and basic institutions (schools, health posts, district offices, road maintenance) work well to produce quality outcomes. These conditions give shape to IDA's comparative advantage in Bhutan in providing high-quality global knowledge and practical expertise. The Bank has fixed costs in preparing and processing IDA projects, and given the availability of substantial alternative assistance to Bhutan, using scarce IDA resources for knowledge assistance over lending preparation will be more cost-effective. *Accordingly, IDA's country assistance strategy will emphasize knowledge transfers first, then lending.*

46. **Knowledge Transfer.** IDA will increasingly place its global knowledge resources at the disposal of the government without tying them to IDA credits. The government has asked for regular consultations, without lending, on aspects of its long-term health and education strategies. It has also asked for help on macroeconomic aspects of development policy, which would build on IDA's routine participation in IMF Article IV consultations. Discussions have begun with the Royal Monetary Authority on a detailed study of the financial sector to help develop a financial sector strategy. Bhutan lacks a solid analytical basis for measuring rural and urban poverty, which would be useful to inform and accelerate its development strategy of inclusive social transformation. IDA will urge the government to carry out a baseline living standards survey, and will be prepared to provide technical staff or other assistance for this important purpose. Possible program lending would need to be preceded by a public expenditure review, and IDA will offer assistance in this area. Bhutan has requested assistance for the development of accounting and auditing standards and skills. These tasks will involve open-ended assistance, either through the ongoing dialogue or through special tasks that may or may not involve specific studies (Table 2). IDA is working with the government to broaden the training of government officials, including greater access to World Bank Institute courses and inviting promising Bhutanese civil servants to Washington for internships of up to nine months.

	<b>AAA Starts<sup>1</sup></b>	<b>Lending</b>
Ongoing	Health Operational Planning Forestry	Education II Forestry III
FY00	Post-Secondary Education Strategy Country Assistance Strategy Financial Sector Strategy	Urban Development Rural Access Roads
FY01	Poverty Analysis Public Expenditure Analysis	--
FY02	--	--

<sup>1/</sup> FY00 includes ongoing activities begun in FY00. AAA assistance is seen as open-ended in that it will respond to the needs of the government as and when needed, and will therefore continue while it is justified in terms of the knowledge transfer needs of the government.

47. Other areas for a knowledge-intensive role for IDA include issues relating to school curriculums, long-term health finance, rural road capacity development, options for employment generation, policy frameworks for economic and sector development, and Bhutan's deficiencies in economic data (Table 3; Annex A1). Such a knowledge-based partnership would involve providing Bhutan with access to the Bank's global knowledge and expertise with the help of visiting IDA missions, World Bank Institute courses (including distance learning), and technical assistance through IDA-supported projects.

48. **Donor Coordination.** The government is interested in greater harmonization of donor support and in discussing the merits of a more program-oriented approach. The Comprehensive Development Framework, which Bhutan's development vision and implementation have anticipated, provides a natural foundation for this (Box 4). As part of its effort to help the government enhance the efficiency and development impact of donor assistance, IDA will seek to build stronger partnerships with Bhutan and other donors on this foundation.

**Box 4: *Bhutan 2020* and the Comprehensive Development Framework**

Bhutan's development practices have anticipated the Comprehensive Development Framework. The emphasis on development as social transformation, the need for ownership of the development strategy, and the emphasis on participation, inclusiveness, and a well-defined framework for donor partnerships are all themes that resonate with *Bhutan 2020*.

Each pillar of the Comprehensive Development Framework is reflected in current practice in Bhutan or in *Bhutan 2020*:

- **Good governance.** The government has a long-standing reputation for honesty and professionalism. Training is a key focus. Large numbers of civil servants at all levels are studying abroad in highly regarded programs. Decentralization is increasing transparency, voice, and information flow, with development decisions increasingly made at the *geog* (community) and *dzongkhag* (district) levels. A greater role for the elected National Assembly and Cabinet is enhancing these crucial values at the central level.
- **Market fundamentals.** The government is modernizing the legal system to meet the needs of a market economy and finalizing a digital GPS-based land survey and titling system. A stringent new bankruptcy law and a high-level committee have boosted enforcement of foreclosures. Competition has been introduced in the banking system, and a new private commercial bank, with Citibank equity involvement, will compete with the government-owned commercial bank.
- **Inclusion.** Bhutan is making a concerted effort to increase access to education and health care. Girls now constitute over 45 percent of primary school students. Infant and maternal mortality rates have dropped sharply. Health clinics are well equipped, with dedicated and well-trained staff committed to both preventive and curative medicine. Bhutan has a long-established school for the blind, and accommodation for the deaf is now also being made in the school system. After an initial overreaction in the 1980s to ethnic tensions, the government is working to create a society in which all nationals benefit equally from development.
- **Communications and transport.** The government continues to improve its road, trail, and ropeway network, with an emphasis on maintenance—increasingly through the private sector—and improved access to remote areas. A communications network now covers all 20 *dzongkhags*. In rural development Bhutan is diversifying into new export crops.
- **Environmental and human sustainability.** Bhutan is making substantial contributions to the global environment through reforestation and biodiversity protection and the export of hydropower to India. Forests cover over 70 percent of the land area—over a quarter of the land area is dedicated in perpetuity as national parks and nature reserves—and there is a growing movement toward community forestry. The government is also focusing on solar power and mini- and micro-hydels. In addition, the government is at the forefront of cultural preservation worldwide. Tourism is limited to sustainable levels, and school textbooks are geared to local values.

Source: *Bhutan 2020: A Vision of Peace, Prosperity, and Happiness*, Royal Government of Bhutan, May 1999.

**Table 3: BHUTAN'S SELECTED DEVELOPMENT PRIORITIES TO BE ASSISTED BY IDA**

Bhutan's Development Vision and Long-term Outcomes	IDA Inputs
<b>CENTRAL DEVELOPMENT CONCEPT</b>	
<ul style="list-style-type: none"> <li>Maximizing Gross National Happiness</li> </ul>	<ul style="list-style-type: none"> <li>Broader support available in future through regular consultations and limited project, sector program, or economy-wide program lending.</li> </ul>
<b>A. Human Development</b>	
Maximize happiness of all Bhutanese to enable them to achieve their full & innate potential.	
<b>1. Education</b>	
<ul style="list-style-type: none"> <li>Achieve universal enrolment <i>as soon as possible</i>.</li> <li>Continually improve the quality &amp; relevance of education.</li> <li>Improve access to education.</li> <li>Develop private schools.</li> </ul>	<ul style="list-style-type: none"> <li>Support through Second Education Credit for basic education</li> <li>RGoB request for regular consultations (without lending) on post-secondary education strategy.</li> <li>Dialogue on school curriculum, secondary and post secondary education planning.</li> </ul>
<b>2. Health</b>	
<ul style="list-style-type: none"> <li>Provide primary health care services for all.</li> <li>Improve quality of health care.</li> <li>Introduce innovative methods of financing health care (e.g. user fees for services on an 'ability to pay' basis).</li> </ul>	<ul style="list-style-type: none"> <li>RGoB request for regular consultations (without lending) on long-term health strategies.</li> <li>Dialogue on long-term health financing.</li> </ul>
<b>3. Economic Growth and Development</b>	
<ul style="list-style-type: none"> <li>Maintain the momentum of development</li> <li>Diversify the economy so as to promote self reliance.</li> <li>generate productive employment</li> </ul>	<ul style="list-style-type: none"> <li>RGoB request for consultations on macroeconomic &amp; financial issues.</li> <li>Poverty data and analysis.</li> <li>Public expenditure review.</li> </ul>
<b>4. Private Sector</b>	
<ul style="list-style-type: none"> <li>Continue to create an enabling environment for the private sector.</li> </ul>	<ul style="list-style-type: none"> <li>Non-lending support to financial sector.</li> </ul>
<b>5. Transport, Communications and Information</b>	
<ul style="list-style-type: none"> <li>Further development of physical infrastructure guided by detailed assessment of environmental &amp; social impact assessment while maintaining friendly &amp; constructive relations with neighboring countries.</li> <li>a) Surface transport. Improve public transport system. <ul style="list-style-type: none"> <li>Develop dry ports at strategic locations on the border with India.</li> </ul> </li> <li>b) Civil aviation. <ul style="list-style-type: none"> <li>Improve international air services.</li> </ul> </li> <li>c) Telecommunications. <ul style="list-style-type: none"> <li>Expand services to rural population.</li> </ul> </li> <li><u>Priority</u>: Prepare &amp; activate an Information Technology (IT) strategy.</li> </ul>	

Bhutan's Development Vision and Long-term Outcomes	IDA Inputs
<b>B. Balanced &amp; Equitable Development</b>	
Ensure that the benefits of development are shared equitably among all income groups and regions so as to promote justice, unity and harmony.	
<b>1. Urbanization</b>	
<ul style="list-style-type: none"> <li>Timely responses to rapid urbanization so as to minimize negative effects .</li> <li>Focus on rural development.</li> <li>Further commercialize agriculture.</li> <li>Establish at most four regional growth centers (as focal points for social infrastructure &amp; services as well as for gov't services) after assessing their environmental impact.</li> <li><u>Priority Area</u>: Eastern Bhutan.</li> <li>Expand existing centers</li> <li>Improve urban design &amp; planning.</li> </ul>	<ul style="list-style-type: none"> <li>Rural Access and Secondary Towns Credits (FY00)</li> </ul>
<b>C. Governance</b>	
Further develop institutions, human resources & a system of governance to promote self-reliance & participatory processes	
<b>1. Resource Mobilization &amp; Development Financing</b>	
<ul style="list-style-type: none"> <li>Reduce reliance on external assistance in the long-term.</li> <li>Explore new sources of revenues &amp; levy user fees for social services on an 'ability to pay' basis.</li> <li>Revenues</li> <li>Private Schools</li> <li>Health</li> <li>Improve the nation's tax base.</li> </ul>	<ul style="list-style-type: none"> <li>Round Table meeting.</li> <li>Economic/Budget advice in the context of the consultations requested by RGoB on macroeconomic, financial, education &amp; health issues.</li> <li>Advice on accounting &amp; audit standards</li> </ul>
<b>D. Environmentally Sustainable Development</b>	
Ensure the nation's response to challenges ahead embody the principles of environmental sustainability & preserve the natural environment.	
<b>1. Forest Regeneration &amp; Biodiversity</b>	
<ul style="list-style-type: none"> <li>Forest protection &amp; regeneration remains a <u>priority</u> in the future but with <i>more</i> sensitivity to maintaining biodiversity.</li> <li>Make full inventory of biodiversity resource base</li> </ul>	<ul style="list-style-type: none"> <li>Bhutan Trust Fund (focus on national parks &amp; biodiversity)</li> <li>Third Forestry Credit in support of environmentally sustainable forest development and use</li> </ul>

Note: Shows only those priorities for which IDA anticipates providing either knowledge or financial assistance.

Source: Excerpted from Annex A1.

49. **Lending.** Based on the government and IDA's joint assessment of Bhutan's needs for development assistance, lending is likely to be at very modest levels and under very special circumstances. This is a continuation of our past approach, under which lending to Bhutan has been a small fraction of its nominal performance-based annual IDA allocation of SDR 10 million. The current program does not propose additional credits during FY00-02 (see Table 2): such credits would be triggered by specific government requests for IDA assistance, usually when an appropriate blend of funding and expert advice is not available from other donors. When provided, IDA credits will remain focused on the priority poverty-reducing areas of human development and infrastructure. In addition to standard project lending and sector program lending, several factors make Bhutan a potentially good candidate for alternative economy-wide program lending, including its comprehensive development vision, well-specified performance benchmarks, strong public institutions, and careful public expenditure stance.

50. Project lending would follow IDA's long-standing project partnerships in education and forestry. IDA has been supporting Bhutan's secondary education vision through two credits co-financed with the Swiss Development Corporation, and is well positioned to assist in developing a tertiary education model. Sector-based program lending would build on the blend of project and sector program lending embedded in the two projects that accompany this CAS, including the future possibility of time-slice financing based on comprehensive donor coordination. Economy-wide program lending—against the general effectiveness of development assistance in Bhutan—is also a possibility under discussion with the government, provided that economic conditions (including a drop in foreign aid or export earnings) require such support. A review of public expenditures, a baseline poverty assessment, macroeconomic monitoring in collaboration with the IMF, and a Poverty Reduction Strategy Paper would need to precede such lending. The government is considering the pros and cons of such support.

51. To ensure that lending remains demand-driven, IDA has been in dialogue with the government on these options, discussing the merits and costs of each approach and its fit with Bhutan's development vision. This dialogue is very mindful of Bhutan's constraints in absorbing the external resources already available and its desire to modernize with "deliberate speed" to avoid the social, cultural, and environmental costs of overly rapid growth. But it is also mindful of the high payoff in social transformation from additional investments in basic social and physical infrastructure. While focusing strategically on knowledge transfers, IDA will continue to explore knowledge-intensive and innovative opportunities for financing such high-value added investments in social and physical infrastructure. The projects accompanying this CAS are two examples of such opportunities.

52. **Development Outcomes.** IDA's strategy of knowledge transfers and limited lending must be and is an integral part of the comprehensive development framework derived from the government's vision, as enunciated in its *Bhutan 2020*. The performance indicators for IDA's strategy are therefore also derived from the milestones the government has set for itself, as described in Annex A1. These milestones are of course not specific to IDA's limited assistance, but in each case represent the interaction of donor assistance derived from the development framework and Bhutan's implementation of such assistance. The government has set these milestones after extensive consultations. Regular and extensive field visits by officials at all levels, combined with the small population (fewer than 100,000 households), mean that the government has a sophisticated and detailed knowledge of conditions and needs across the whole of Bhutan. As such, the government's milestones represent a blend of realistic targets over the medium term—by which IDA would measure its performance—and stretch goals in the short

run that indicate the clear direction the government wishes to pursue (and which may sometimes be quite attainable given Bhutan's small population.)

53. **Consultations.** IDA has engaged in numerous consultations with all levels of Bhutanese society throughout the preparation of this assistance strategy. Discussions with government and civil society in Thimphu and in rural areas were held by teams covering education, forestry, urban development, infrastructure, and social development, with two extensive field visits by Bank anthropologists, including to the South, to learn about and discuss the social and ethnic aspects of Bhutan's development. *Bhutan 2020* and the Eighth Five-Year Plan are founded on exhaustive, open, and highly participatory consultations at all levels of society, including the *chimis* (elected members of the National Assembly) and *gups* (elected village leaders, who are an integral part of each *dzongkhag's* local government).

### E. BHUTAN'S DEVELOPMENT PARTNERSHIPS

54. Bhutan differs from most other aid-dependent countries in that the government has a strong vision and a strong sense of development priorities—and of the comparative advantages of various donors—and determines on this basis where technical and financial assistance is most needed and which donor can best provide it. The admirably small government means that donor missions can impose a high cost in scarce government officials' time. The government has been exceptionally proactive in managing donor assistance, fitting aid into a well-defined framework, rather than allowing donors to drive its development programs (Table 4). The government has actively encouraged very close liaison between donors and facilitated this objective by limiting the number of donors, both overall and within each sector. In forestry and education, for example, IDA and Switzerland have effectively been operating as a single donor. This well thought-out framework has also emphasized partnerships with relatively small donors, with the exception of India, which has remained Bhutan's major development partner over the past 40 years. Other important partners include Austria, Denmark, Germany, Japan, the Netherlands, Switzerland, the Asian Development Bank, the European Commission, UNDP, and UNICEF. Among other important initiatives, UNDP has organized the donor Round Table Meetings, chaired jointly by the government, UNDP, and IDA.

55. The congruence between Bhutan's vision and the approach suggested by the Comprehensive Development Framework provides unique opportunities for strengthening the partnerships between the government and the donor community, including IDA. There is already a strong foundation on which to build. *Bhutan 2020* includes detailed and quantified milestones or benchmarks for all the government's priority areas, from population, health, and education to decentralization and participation (Annex A1). The government is working to establish harmonized procedures, including for procurement and disbursement.

56. UNDP has pioneered the concept of a sustainable development partnership with the government and has assisted it in bringing coherence to donor activities, partly through its substantial assistance for strengthening government planning and program management capacities. The Netherlands is supporting an innovative environment partnership with Bhutan, Costa Rica, and Benin. Sector-by-sector aid coordination meetings are held among the donors resident in Thimphu, with participation from the nonresident donors (Japan, the Asian Development Bank, the International Monetary Fund, and IDA), when possible.

**Table 4: Bhutan's Comprehensive Framework of Ongoing Development Assistance**

Dev. Partner	Governance	Education	Health	Forestry	Environment	Rural Dev't	Roads	Urban Dev	Power	Telecomm
Austria					Bhutan Trust Fund				Basochu	
Denmark	Decentralization, Strengthen Royal Audit Authority, Tax Administration Assistance		Integrated Primary Health Care, Essential Drugs & Safe Water		Land use & Environ. Planning Bhutan Trust Fund	Agro-industries		Thimphu & Phuntsholing		
Germany		Tech. & Vocational Education	Upgrading Health Posts	Conserv. & Sust. management		Promotion of cash crops				
India		Teacher Salaries, School Construction	Malaria Eradication				Construction & maintenance		Tala, Kurichu, Bunakha	Radio transmission
Japan						Paro Rural Dev.	Paro roads and bridges		Micro-hydels	Microwave Tel. Network
Netherlands	Decentralization				Biodiversity, Bhutan Trust Fund	Cash Crops, Horticulture Develop., Zhemghang Rural Dev.	Rural roads management		Solar Power	
Norway					Bhutan Trust Fund					
Switzerland	Strengthen Royal Audit Authority	Primary/secondary Teacher training (with IDA)		Sustainable Use, Protection & mgt. Of forest		Promotion of Cash Crops, Livestock Dev., Natural Resource Training Center	Bridges & Trails			
ADB	Strengthen Min. of Finance	Tech. & Vocational Education		Forest development		Irrigation Support	Highway maintenance planning	Town Development	Rural Electrification	
EU						Livestock/Agri. Ext. Service				
GEF					Bhutan Trust Fund					
IDA	Round Table, Econ. & Budget Advice	Prim. & Lower Sec. Teacher Training	Consultations on long-term health finance and infectious disease	Sustainable Use, Protection & Mgt. Of Forests	GEF supervision of Bhutan Trust Fund		Support RGOB Prog. of improving rural access, initially in Zhemghang, Trashigang, Trashiyangtse & Lhuentse	Secondary Towns		Telecomm corporatization
UNDP	Round Table, Planning & Budgeting, Aid Coord., Priv. Sector Dev., Modernization of Legal System				National Parks & Biodiversity	Promotion of Cash Crops				
UNICEF		Prim. & Lower Sec. Teacher Trng., Prim. Educ, Adult Literacy	Immunization, MCH, Family Planning							
WFP		School Meals					Food-For-Work			
WHO			Disease Prevention, Human Res. Dev.							
WWF					Bhutan Trust Fund					

## F. RISKS

57. Bhutan faces two kinds of development risk. First, it is subject to vulnerability arising from its external environment—the heavy reliance of the economy on power exports to India and on financial support from India and foreign aid in general. The relationship with India continues to be one of principled partnership, with no emerging political problems that would suggest increased vulnerability. The development effectiveness of aid in Bhutan suggests that the country will continue to receive substantial aid flows, but Bhutan's growing foreign exchange reserves could lead some donors to reallocate aid flows to other countries and create some uncertainty about the size of future aid flows. The government's long-term goal is to reduce its reliance on foreign aid. Macroeconomic stability and creditworthiness are not themselves likely to be of concern over the medium term because of Bhutan's history of fiscal prudence, its strong balance of payments position with very little debt (all concessional), and the nominal anchor provided by the currency peg to the Indian rupee.

58. Second, and perhaps much more important, Bhutan faces the risk of rising social and political tensions from rapid population and economic growth, particularly if growth does not yield universal improvements in living standards. GDP and employment growth will remain a function of how well Bhutan strikes a balance between economic growth and strong national concerns about preserving its environment and maintaining its culture. These issues of long-term social and political vulnerability—of how to match the gains from 6-7 percent GDP growth to rising expectations of welfare improvements and expanding employment opportunities—are thus of greater concern. More immediately, unrest in the south related to Nepali-speaking minorities has attracted considerable attention. The government is attempting to negotiate a just settlement of the refugee issue together with the Nepalese government. In the east, the incursion into Bhutan of rebels opposing the Indian government in Assam poses risks, but the government is working with the Indian government to contain such incursions.

James D. Wolfensohn  
President

February 22, 2000

By Shengman Zhang

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
<b>Central Development Concept</b>	Maximizing Gross National Happiness.		<p>Broader support available in the future, through regular consultations and limited project, sector program, or economy-wide program lending.</p> <p><u>Past Inputs:</u> IDA has supported the vision and values via technical assistance, traditional project lending in forestry, education and calcium carbide production.</p>	
<b>A. Human Development</b>	Maximize happiness of all Bhutanese to enable them to achieve their full & innate potential.	<p><i>Existing policy instruments -</i></p> <p>Royal Decree of Population, 1995 Health Trust Fund launched. Health Sector Master Plan launched. Youth Welfare Trust Fund launched. Hydropower Dev. Master Plan (1990-2010). Horticulture Master Plan. Master Plan for Cottage, Small and Medium Industries. Telecommunications Master Plan Postal Services Master Plan</p>		
1. Population	<p>Reduce population growth.</p> <p>Promote smaller family size nationally. Introduce pop. educ. &amp; awareness programs for all adolescents &amp; adults.</p>	<p>Reduce pop. growth rate to</p> <p>(a) 2.08% per annum by 2002 (b) 1.63% per annum by 2007 (c) 1.31% per annum by 2012</p> <p>Reduce av. # of children per woman from 5 to 2 by 2012. Implement proposed National Population Policy.</p>		UNICEF UNFPA
2. Education	<p>Achieve universal enrolment <i>as soon as possible</i>.</p> <p>Continually improve the quality &amp; relevance of</p>	<p>Achieve</p> <p>(a) universal Primary School enrolment by 2002. (b) full enrolment at Jr. High School (Class 8) by 2007. (c) full enrolment at High School (Class 10) by 2012. Full Bhutanization of</p> <p>(a) primary school curriculum is largely completed. (b) secondary school curricula by 2007. Introduce operational distance education program by</p>	<p>RGoB request for regular consultations (without lending) on post secondary education strategy. Dialogue on school curriculum, secondary &amp; post secondary education planning.</p> <p>Education II (\$13.2 mill.) March 1998 (ongoing)</p>	<p>Primary and lower secondary education &amp; teacher training</p> <p>IDA Switzerland UNICEF (also adult literacy)</p>

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
	<p>education.</p> <p>Improve access to education.</p> <p>Develop private schools.</p>	<p>2007.</p> <p>Achieve the full adult literacy rate for all developing countries by 2017.</p> <p>Establish a National University by 2007.</p> <p>Establish Doethang Engineering College by 2002.</p> <p>Implement proposed Education Sector Master Plan.</p>	<p><u>Past Inputs:</u> Primary Education (\$4.2 mill.) April 1988 (Primary, lower secondary &amp; teacher training).</p>	<p>India (teacher salaries &amp; school construction)</p> <p>WFP (School Meals)</p> <p>ADB/Germany (technical &amp; vocational education)</p>
3. Health	<p>Provide primary health care services for all.</p> <p>Improve quality of health care.</p> <p>Introduce innovative methods of financing health care (e.g. user fees for services on an 'ability to pay' basis).</p>	<p>Increase life expectancy to current av. for all developed countries by 2012. (i.e. 77 years).</p> <p>Achieve current av. of doctor/pop. for all developing countries by 2007. (1.2 per 1000 persons).</p> <p>Introduce operational telemedicine by 2002.</p> <p>By 2007, reduce to curr. av. for all developing countries</p> <p>(a) Infant Mortality Rate (from 71 to 60).</p> <p>(b) Maternal Mortality Rate (from 3.8 to 1.8 per 100,000 live births).</p> <p>(c) Under-5 Mortality Rate (from 96.9 to 84).</p> <p>Introduce operational system of private health care by 2007.</p> <p>(d) HIV prevalence below 1% of adult population.</p>	<p>RGoB request for regular consultations (without lending) on long-term health strategies.</p> <p>Dialogue on long-term health financing.</p>	<p>UNICEF/WHO/ Denmark (primary health care)</p> <p>India (malaria eradication)</p> <p>Germany (upgrading health services)</p>
4. Economic Growth and Development	<p>Maintain the momentum of development</p> <p>Diversify the economy so as to</p> <p>(i) reduce vulnerabilities.</p> <p>(ii) promote self reliance.</p>	<p>Install 2,000 MW of hydropower by 2012.</p> <p>Install 3,000 MW of hydropower by 2017</p> <p>Increase value of horticultural exports 200% by 2007 &amp; 300% by 2012.</p> <p>Increase share in GDP of</p> <p>(a) manufacturing to 30% by 2012.</p> <p>(b) tourism to 25% by 2017</p> <p>Achieve a three-fold increase in real income of farmers by 2012.</p> <p>Increase revenues from tourism 100% by 2012 &amp; 150% by</p>	<p>RGoB request for consultations on macroeconomic &amp; financial issues.</p> <p>Poverty data and analysis.</p> <p>Public expenditure review.</p> <p><u>Past Inputs:</u> Calcium Carbide (\$9 mill.) May 1985.</p>	<p>India/Austria (hydropower)</p> <p>Japan (micro-hydals)</p> <p>ADB (economic advice)</p>

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
	(iii) generate productive employment.	2017. Implement Tourism and Industrial Dev. Master Plans presently in preparation.		
5. Private Sector	Continue to create an enabling environment for the private sector. Increase this sector's role in the nation's future dev. Create jobs to attract young people. Expand opportunities for small businesses, especially <i>outside</i> service-oriented activities. Improve access of private firms to capital technology & know-how.	Simplify licensing arrangements. Introduce unambiguous commercial law. Implement proposed long-term strategy for the development of the private sector.	Non-lending support to financial sector	UNDP (Institutional/Legal framework) ADB (financial sector privatization)
6. Transport, Communications and Information	Further development of physical infrastructure guided by detailed assessment of environmental & social impact assessment while maintaining friendly & constructive relations with neighboring countries. (i) Surface transport. Improve public transport system.  Develop dry ports at strategic locations on the border with India.	Implement proposed Civil Aviation Master Plan and Master Plans for Road Sector and Surface Transport presently under preparation.  Ensure that 75% of rural pop. live within half-day's walk from nearest road by 2012. Upgrade current national trunk roads to take 30-ton trucks by 2007. Complete second transnational highway by 2017. Construct dry ports at (a) Phuentsholing by 2002 (b) Gaylegphu by 2007 (c) Samdrup Jongkhar by 2007. Introduce domestic air services by 2002 (service to	Rural Access Project in support for RGoB's program of improving rural access in districts with poorly developed infrastructure (e.g. Zhemghang, Trashigang, Trashiyangtse & Lhuentse). Dialogue on rural road capacity development.	IDA (rural access)  India (road construction & maintenance) Japan (Paro roads) Switzerland (bridges & trails) WFP (Food for Work)

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
	<p>(ii) Civil aviation.  Improve &amp; strengthen international air services.</p> <p>(iii) Telecommunications. Expand <i>all</i> services to the rural population.</p> <p><u>Priority:</u> Prepare &amp; activate an Information Technology (IT) strategy.</p>	<p><i>eastern</i> Bhutan is high priority). Establish improved external air links with full instrument landing system capacity by 2017. Introduce national television by 2000. Ensure all major villages &amp; settlements have a post office by 2002. Develop &amp; establish a comprehensive IT strategy by 2002.</p> <p>Introduce by 2000, fully operational (a) Intranet services &amp; email systems. (b) access to Internet.</p>	<p>IDF for Corporatization of telecommunications.</p>	<p>IDA (telecomm.) Japan (microwave, telephone network) India (radio transmission)</p>
<b>B. Culture &amp; Heritage</b>	<p>Interpret the rich cultural heritage in a dynamic &amp; development-oriented manner to ensure that it maintains its relevance for a society in transformation. Make inventory of the nation's culture &amp; heritage. Preserve, conserve &amp; promote the culture &amp; heritage. Promote the traditional architectural style.</p>	<p><i>Existing policy instruments -</i> Heritage Fund launched.</p> <p>Complete inventory by 2007.</p> <p>Prepare Culture &amp; Heritage Act by 2002.</p> <p>Prepare Construction Code by 2002.</p>		<p>India/Austria (Dzong renovation)  Netherlands/Denmark (Cultural support)</p>
<b>C. Balanced and Equitable Development</b>	<p>Ensure that the benefits of dev. are shared equitably among all income groups &amp; regions so as to promote justice, unity &amp; harmony.</p>	<p><i>Existing policy instruments -</i> Royal Decree on Water and Sanitation, 1992/93. Long-term Human Settlement Development Master Plan (1999-2020) launched.</p>		

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
1. Urbanization	<p>Timely responses to rapid urbanization so as to minimize negative effects of this problem. Focus on rural development. Further commercialize agriculture. Establish at most four regional growth centers (as focal points for social infrastructure &amp; services as well as for gov't services) after assessing their environmental impact. <u>Priority Area:</u> Eastern Bhutan. Expand existing centers Improve urban design &amp; planning.</p>	<p>Formulate growth center strategy by 2002.</p> <p>Complete urban dev. plans for Thimphu &amp; Phuentsholing by 2002. Complete dev. plans for other major towns by 2002.</p>	Rural Access and Secondary Towns Credits (FY00).	<p>IDA/ADB (town development)</p> <p>Japan (Paro rural dev.) UNDP/Switzerland/ Germany/Netherlands (cash crops).</p> <p>Denmark (urban dev.)</p>
2. Access to basic services and infrastructure.	<p>Ensure equitable access to Electricity</p> <p>Potable water</p> <p>Safe sanitation</p>	<p>Implement proposed Rural Electrification Master Plan. Provision of electricity to (a) 50% of rural pop. by 2012. (b) 75% of urban pop. by 2020. Provision of potable water supplies to (a) 80% of rural pop. by 2002 &amp; 90% by 2007. (b) 90% of urban pop. by 2002. Provision of safe sanitation to 75% of rural pop. by 2002 &amp; 90% by 2007.</p>		<p>ADB (rural electrification) Netherlands (solar power)</p> <p>Denmark (safe water)</p>
3. Vulnerable & disadvantaged groups.	Rapid responses to the needs of vulnerable & disadvantaged groups.	Program to limit population in ecologically fragile areas.		
4. Equitable Development	Prevent the growth of income inequalities. Develop a progressive system of income taxes.	Introduce a Personal Income Tax (PIT) by 2000. See above.		Denmark (Tax assistance)

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
<b>D. Governance</b>	Further develop institutions, human resources & a system of governance to promote self-reliance & participatory processes.	<i>Existing policy instruments -</i> DYT Chatrims, 1981 GYT Chatrims, 1992. Decentralization Guidelines, 1993. Human Resources Development Master Plan (1997-2020).		
1. Management of Development	Progressively respond to new needs and requirements. Compact civil service with adequate highly qualified professionals.	Revise Decentralization Guidelines by 2002.  Establish national Monitoring and Evaluation System by 2002.		Switzerland/ Denmark/ ADB (strengthen institutions)
2. Law & Jurisprudence	System continues to evolve in response to the needs of a society in change, even though it remains anchored in Buddhist principles.	Measures to make the system of law proactive in terms of the capacity to anticipate change & the appropriate legal instruments needed.		UNDP (modernize legal systems)
3. Decentralization & Participation	Devolution of new powers & responsibilities to the dzongkhag and geog levels.	Enhance the capacity of DYT's & GYT's to prepare their own plans by 2005. Establish financial practice and guidelines for Geog funds by 2007. Establish well-equipped Gup offices in all Geogs by 2007. Implement Local Development Funds in (a) 100 Geogs by 2007, and (b) all Geogs by 2012. Introduce Geog development funds in all Dzongkhags by 2017.		Netherlands/ Denmark (decentralization)
4. Human Resources Development (HRD)	HRD strategy is guided by the HRD Master Plan (1997-2002) which is presently under review to cover a 20-year period. Reduce the nation's reliance on expatriates, especially in the private	Implement Long-Term Manpower Development Plan.  Establish an independent unit for manpower planning by 2002. Capacity of RIM for management training to be fully		Thailand/ Netherlands/ India/Colombo Plan (specialized technical &

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
	sector.  Provide tertiary training locally also.	developed by 2007.  Establish Doethang Engineering College by 2002. Establish a National University by 2007.		vocational training)
5. Resource Mobilization & Development Financing	Reduce reliance on external assistance in the long-term. Explore new sources of revenues & levy user fees for social services on an 'ability to pay' basis. Revenues  Private Schools  Health  Improve the nation's tax base.	New hydropower schemes come on stream in 2006.  Examining feasibility of introducing sales tax on goods & services & property tax. Examining possibility of revising the structure of royalties on forestry products. Implement proposed Education Sector Master Plan. Introduce operational system of private health care by 2007.  Already embarked on a major program of tax reform.	Round Table meeting. Economic/Budget advice in the context of the consultations requested by RGoB on macroeconomic, financial, education & health issues.  Advice on accounting and audit standards.	UNDP/IDA
<b>E. Environmentally Sustainable Development</b>	Ensure the nation's response to challenges ahead embody the principles of environmental sustainability & preserve the natural environment.	<i>Existing policy instruments -</i> Forest & Nature Conservation Act of 1995. National Forestry Master Plan (1996-2010). National Environment Strategy. National Biodiversity Action Plan. National Environmental Action Plan under preparation.		
1. Forest Regeneration & Biodiversity	Forest protection & regeneration remains a <u>priority</u> in the future but with <i>more</i> sensitivity to maintaining biodiversity.	Continually maintain at least 60% forest cover.	Bhutan Trust Fund for Environmental Conservation (focus on national parks & biodiversity). Forestry Dev. III (\$5.4 mill.) July 1993 (ongoing). <u>Past Inputs:</u> Forestry Dev. I (\$5.5 mill.) April 1984. Forestry Dev. II (\$1.1 mill.) April 1988.	Major donors of Bhutan Trust Fund: GEF/WWF/ Netherlands, / Denmark/Austria/ Norway (biodiversity) IDA/Switzerland/ GTZ (forestry)
2. Conservation & Development	Make full inventory of the nation's biodiversity resource base.	Inventorying of biodiversity resource base continues through 2002 and beyond.	Bhutan Trust Fund for Environmental Conservation	UNDP/Denmark (biodiversity) Switzerland/

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
				Germany/ IDA (conservation & sustainable manage- ment)
3. Greening of the National Accounts.	<u>Priority:</u> Include the contribution to the economy by the environment & by ecological services in the calculation of GDP.	Adapt System of National Accounts to include the compi- lation of environmental satellite accounts by 2002.		Denmark (assistance to National Environment Commission)
4. Institutionalize Capacities for Environmental Impact Assessments (EIAs).	<u>High Priority:</u> Institutional- ize capacities for con- ducting EIAs at all levels of government.	EIA unit already established in National Environment Commission (NEC). Implement proposed EIA Legislation. Environment Assessment Process (EAP) approved by NEC in Feb.1999. Introduce (a) mandatory EIAs for all large-scale projects by 2002, and (b)EIAs for all physical infrastructure projects by 2007. Extend capacity to conduct EIAs to Dzongkhag level by 2007. Prepare fully elaborate (a) standards for water quality & environmental health by 2002 and (b) air quality standards by 2007.		Denmark/UNDP (Insti- tutional assistance)
5. Watershed Management	Preparation of Manage- ment Plans for watershed areas as follows: <u>High Priority:</u> Wang Chu Puna Tsang Chu, Mangde Chu, Kuri Chu and Dangme Chu	Complete by 2002. Complete by 2007.		Denmark (land use & environment planning)
6. Environmental Legislation	New environmental legis- lation sensitive to ethical, religious & cultural values as well as traditional systems of resource management. Need legislation that	National Environment Protection Act approved by Parlia- ment in July 1999.		Denmark (Institu- tional/technical assistance)

## BHUTAN's Development Priorities

RGoB's Bhutan 2020	RGoB's Desired Long-Term Outcomes	RGoB's Performance Milestones	IDA's Inputs	Lead Donors
	consolidates & builds on existing legislation. Need initiatives to review related legislation with a view to updating them, if necessary (e.g. Inheritance Act, Land Act, Live-stock Act).			

**Notes:**

DYY: Dzongkhag Yargye Tshogchung	Dzongkhag	District
GEF: Global Environment Facility	Chu	River/Water.
GYT: Gewog Yorgye Tshogchung	Chatrim	Rules and regulations.
Geog: Administrative unit under a Dzongkhag.	Gup	Elected leader of the geog
RGoB: Royal Government of Bhutan	RIM	Royal Institute of Management

Social indicators for Bhutan are from RGoB and may differ from that in the World Bank Central Databases.

With regard to performance indicators, data for high income countries is used for developed countries while data for lower & middle income countries is used for developing countries.

# Bhutan at a Glance

Annex B1

## POVERTY and SOCIAL

### 1998

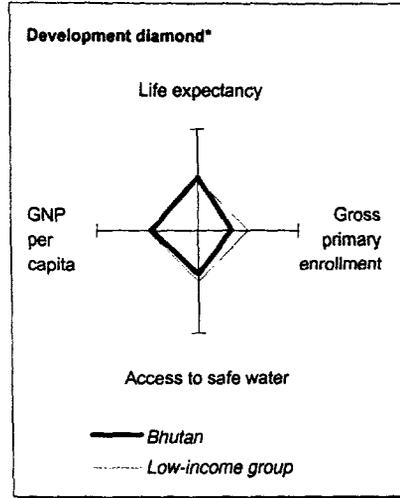
	Bhutan	South Asia	Low-income
Population, mid-year (millions)	0.76	1,305	3,515
GNP per capita (Atlas method, US\$)	480	430	520
GNP (Atlas method, US\$ billions)	0.36	555	1,844

### Average annual growth, 1992-98

	Bhutan	South Asia	Low-income
Population (%)	2.9	1.8	1.7
Labor force (%)	2.3	2.3	1.9

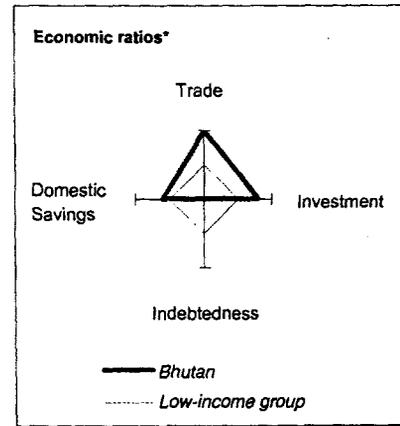
### Most recent estimate (latest year available, 1992-98)

	Bhutan	South Asia	Low-income
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	15	27	31
Life expectancy at birth (years)	66	62	63
Infant mortality (per 1,000 live births)	71	77	69
Child malnutrition (% of children under 5)	38	53	..
Access to safe water (% of population)	64	81	74
Illiteracy (% of population age 15+)	46	49	32
Gross primary enrollment (% of school-age population)	72	100	108
Male	..	109	113
Female	..	90	103



## KEY ECONOMIC RATIOS and LONG-TERM TRENDS

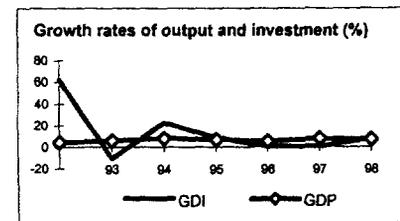
	1977	1987	1997	1998
GDP (US\$ billions)	..	0.28	0.40	0.43
Gross domestic investment/GDP	..	30.5	48.1	47.3
Exports of goods and services/GDP	..	21.4	33.0	33.2
Gross domestic savings/GDP	..	17.2	38.8	37.9
Gross national savings/GDP	..	10.1	35.8	36.5
Current account balance/GDP	..	-34.0	-14.1	-10.8
Interest payments/GDP	..	0.2	0.6	0.5
Total debt/GDP	..	14.4	30.3	27.8
Total debt service/exports	..	1.0	6.0	6.3
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..



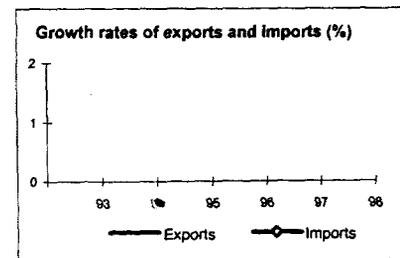
(average annual growth)	1977-87	1988-98	1997	1998	1999-03
GDP	7.9	6.1	7.8	7.1	7.1
GNP per capita	7.2	2.0	2.6	2.4	3.1
Exports of goods and services	..	..	..	..	..

## STRUCTURE of the ECONOMY

(% of GDP at factor cost)	1977	1987	1997	1998
Agriculture	..	46.0	37.8	38.2
Industry	..	27.4	36.5	36.5
Manufacturing	..	5.8	11.4	11.6
Services	..	26.6	25.8	25.4
Private consumption	..	65.2	35.8	36.2
General government consumption	..	17.6	25.5	25.8
Imports of goods and services	..	34.6	42.3	42.6



(average annual growth)	1977-87	1988-98	1997	1998
Agriculture	6.2	3.1	3.1	3.4
Industry	14.8	9.0	3.8	7.3
Manufacturing	11.6	12.2	3.6	13.0
Services	6.7	7.0	16.1	7.2
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Gross domestic investment	4.7	9.9	0.3	7.5
Imports of goods and services	..	..	..	..
Gross national product	9.4	5.0	5.7	5.5

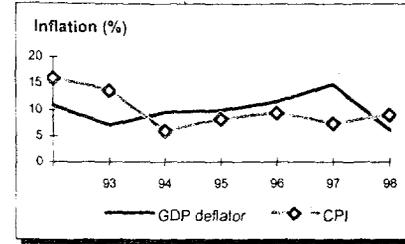


Note: 1998 data are preliminary estimates.

\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

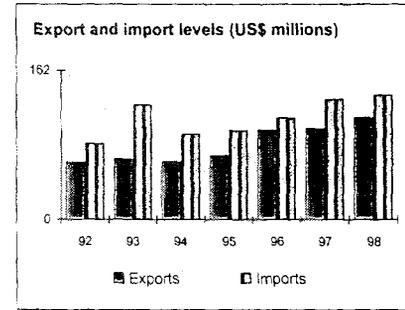
**PRICES and GOVERNMENT FINANCE**

	1977	1987	1997	1998
<b>Domestic prices</b>				
<i>(% change)</i>				
Consumer prices	..	4.8	7.4	9.0
Implicit GDP deflator	..	8.6	14.7	5.9
<b>Government finance</b>				
<i>(% of GDP, includes current grants)</i>				
Current revenue	..	..	18.5	19.9
Current budget balance	..	..	0.6	3.3
Overall surplus/deficit	..	..	-2.3	3.2



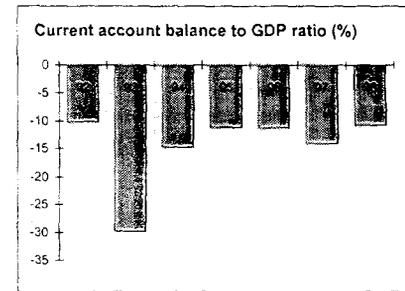
**TRADE**

	1977	1987	1997	1998
<i>(US\$ millions)</i>				
Total exports (fob)	..	29	99	111
Electricity	..	..	21	37
Agric. Prods.	..	..	12	..
Manufactures	..	..	..	..
Total imports (cif)	..	101	131	136
Food	..	..	..	..
Fuel and energy	..	..	..	..
Capital goods	..	..	..	..
Export price index (1995=100)	..	..	..	..
Import price index (1995=100)	..	..	..	..
Terms of trade (1995=100)	..	..	..	..



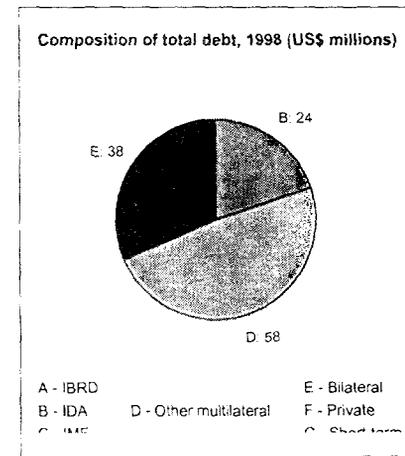
**BALANCE of PAYMENTS**

	1977	1987	1997	1998
<i>(US\$ millions)</i>				
Exports of goods and services	..	50	121	146
Imports of goods and services	..	144	183	203
Resource balance	..	-95	-62	-57
Net income	..	0	0	0
Net current transfers	..	0	6	11
Current account balance	..	-95	-56	-47
Financing items (net)	..	79	78	92
Changes in net reserves	..	16	-22	-45
<b>Memo:</b>				
Reserves including gold (US\$ millions)	..	..	176	218
Conversion rate (DEC, local/US\$)	8.7	13.0	36.3	41.3



**EXTERNAL DEBT and RESOURCE FLOWS**

	1977	1987	1997	1998
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	0	40	121	120
IBRD	0	0	0	0
IDA	0	9	23	24
Total debt service	0	1	7	9
IBRD	0	0	0	0
IDA	0	0	0	0
Composition of net resource flows				
Official grants	..	..	74	85
Official creditors	0	16	14	2
Private creditors	0	0	-2	-2
Foreign direct investment	..	0	0	0
Portfolio equity	..	0	0	0
World Bank program				
Commitments	0	0	0	14
Disbursements	0	5	1	1
Principal repayments	0	0	0	0
Net flows	0	5	1	1
Interest payments	0	0	0	0
Net transfers	0	5	1	0



**Bhutan - Selected Indicators of  
Bank Portfolio Performance and Management**

Indicator	1996	1997	1998	1999 1/
<i>Portfolio Assessment</i>				
Number of Projects under implementation <sup>a</sup>	2	2	2	2
Average implementation period (years) <sup>b</sup>	5.60	6.60	2.70	3.65
Percent of problem projects <sup>a, c</sup>				
by number	0.00	0.00	0.00	0.00
by amount	0.00	0.00	0.00	0.00
Percent of projects at risk <sup>a, d</sup>				
by number	0.00	0.00	0.00	0.00
by amount	0.00	0.00	0.00	0.00
Disbursement ratio (%) <sup>e</sup>	17.16	15.75	9.18	3.76
<i>Portfolio Management</i>				
CPPR during the year (yes/no)	No	No	No	No
Supervision resources (total US\$)	110.10	127.47	64.53	150.26
Average Supervision ('000 US\$/project)	55.05	63.73	32.26	75.13

Memorandum item	Since FY80	Last five FYs
Projects evaluated by OED		
by number	5	3
by amount (US\$ millions)	22.76	10.76
Percent rated U or HU		
by number	0.00	0.00
by amount	0.00	0.00

- a. As shown in the Annual Report on Portfolio Performance (except for current FY)
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.
- 1/ As of November 1999.

## Bhutan - Bank Group Program Summary, FY 2000-2002

### Proposed IDA Base-Case Lending Program, FY 2000-2002<sup>a</sup>

<i>FY</i>	<i>Project</i>	<i>US\$(M)</i>	<i>Strategic rewards<sup>b</sup> (H/M/L)</i>	<i>Implementation<sup>b</sup> risks (H/M/L)</i>
2000	RURAL ACCESS ROADS	10.0	M	L
	URBAN DEVELOPMENT	12.0	M	L
	<b>Subtotal</b>	<b>22.0</b>		
	<b>Total, FY 2000-2002</b>	<b>22.0</b>		

- a. This table presents the proposed program for the next three fiscal years. Based on the CAS, which emphasizes knowledge transfers over resource transfers, no further credits are currently planned but will be considered if requested by the Royal Government of Bhutan and if prepared, will come to the Board for approval under normal procedures.
- b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).

## Bhutan—Summary of Nonlending Services

<i>Product</i>	<i>FY</i>	<i>Cost (US\$000)</i>	<i>Audience<sup>a</sup></i>	<i>Objective<sup>b</sup></i>
<b>Recent completions</b>				
Country Economic Memorandum	FY97	89	Govt, Bank, donor, public dissemination	Knowledge generation, public debate, problem solving
<b>Underway in FY00</b>				
Country Assistance Strategy	FY00	125	Govt, Bank, donor, public dissemination	Knowledge generation, public debate, problem solving
Global Environment Fund	FY00-02	43	Govt, Bank, donor	Problem solving
Health Operational Planning	FY00-02	225	Govt, Bank, donor	Knowledge generation, public debate
Forestry AAA	FY00-02	180	Govt, Bank, donor	Knowledge generation, problem solving
<b>Planned for FY00 and beyond 1/</b>				
Post-Secondary Education Strategy	FY00-02	210	Govt, Bank, donor	Knowledge generation, problem solving
Poverty Analysis	FY01-02	130	Govt, Bank, donor, public dissemination	Knowledge generation, public debate, problem solving
Financial Sector Strategy	FY00-02	180	Govt, Bank, donor	Knowledge generation, problem solving
Public Expenditure Analysis	FY01-02	130	Govt, Bank, donor	Knowledge generation, problem solving

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

1/ AAA assistance is seen as open-ended in that it will respond to the needs of the government as and when needed, and will therefore continue while it is justified in terms of the knowledge transfer needs of the government.

## Bhutan: Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1992-98	South Asia	Low-income
<b>POPULATION</b>					
Total population, mid-year (millions)	0.44	0.54	0.76	1,305	3,515
Growth rate (% annual average)	1.4	2.0	2.9	1.8	1.7
Urban population (% of population)	3.5	..	15.0	27.3	30.7
Total fertility rate (births per woman)	..	..	5.8	3.5	3.2
<b>POVERTY</b>					
<i>(% of population)</i>					
National headcount index	..	..	..	..	..
Urban headcount index	..	..	..	..	..
Rural headcount index	..	..	..	..	..
<b>INCOME</b>					
GNP per capita (US\$)	..	290	480	430	520
Consumer price index (1995=100)	..	38	109	117	122
Food price index (1995=100)	..	..	..	..	..
<b>INCOME/CONSUMPTION DISTRIBUTION</b>					
Gini index	..	..	..	..	..
Lowest quintile (% of income or consumption)	..	..	..	..	..
Highest quintile (% of income or consumption)	..	..	..	..	..
<b>SOCIAL INDICATORS</b>					
<b>Public expenditure</b>					
Health (% of GDP)	..	..	3.6	..	..
Education (% of GDP)	..	..	3.5	..	..
Social security and welfare (% of GDP)	..	..	..	..	..
<b>Gross primary school enrollment rate</b>					
<i>(% of age group)</i>					
Total	35	..	72	100	108
Male	..	..	..	109	113
Female	..	..	..	90	103
<b>Access to safe water</b>					
<i>(% of population)</i>					
Total	..	..	64	81	74
Urban	..	..	75	84	..
Rural	..	..	54	80	..
<b>Immunization rate</b>					
<i>(% under 12 months)</i>					
Measles	..	43	84	81	80
DPT	..	52	87	87	82
Child malnutrition (% under 5 years)	..	..	38	53	..
<b>Life expectancy at birth</b>					
<i>(years)</i>					
Total	46	..	66.0	62	63
Male	..	..	65.9	62	62
Female	..	..	66.1	63	64
<b>Mortality</b>					
Infant (per thousand live births)	142	..	71	77	69
Under 5 (per thousand live births)	..	..	97	100	97
<b>Adult (15-59)</b>					
Male (per 1,000 population)	..	..	..	413	557
Female (per 1,000 population)	..	..	..	423	513
Maternal (per 1,000 live births)	7.7	..	3.8	..	..

Sources: 1999 World Development Indicators CD-ROM, World Bank and Royal Government of Bhutan.

## Bhutan - Key Economic Indicators

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
<b>National accounts (% of GDP)</b>									
Gross domestic product	100	100	100	100	100	100	100	100	100
Net indirect taxes	4	4	3	3	5	5	5	5	5
Agriculture	40	39	39	36	36	36	36	36	35
Industry	28	33	32	35	35	35	35	35	38
Services	27	24	26	25	24	24	24	24	22
Total Consumption	55	51	62	61	62	61	60	59	56
Gross domestic fixed investment	52	51	47	46	45	45	45	46	46
Government investment	14	14	15	15	15	15	15	15	16
Private investment	38	37	32	31	30	30	30	31	31
Change in stocks	3	2	1	2	3	4	4	4	3
Exports of goods & services	30	37	34	33	33	33	33	33	35
Imports of goods & services	39	42	44	42	43	42	42	41	40
Gross domestic savings	45	49	38	39	38	40	40	41	44
Gross national savings <sup>a</sup>	42	41	31	36	36	38	38	40	43
<i>Memorandum items</i>									
GDP (US\$ million at current prices)	271	317	342	404	428	446	492	538	594
GNP per capita (US\$, Atlas method)	360	390	420	460	480	540	570	600	640
Real annual growth rates (%)									
GDP at market prices	8.1	6.8	5.5	7.8	7.1	7.0	7.0	7.1	7.2
GDP at factor cost	6.4	7.4	6.1	7.3	5.8	6.0	6.0	6.1	6.2
Gross Domestic Income	..	..	..	..	..	..	..	..	..
Real annual per capita growth rates (%)									
GDP at market prices	5.0	3.7	2.4	4.7	4.0	3.9	3.9	4.0	4.1
Total consumption	..	..	..	..	..	..	..	..	..
Private consumption	..	..	..	..	..	..	..	..	..
<b>Balance of Payments (millions of US\$)</b>									
Exports of goods & services	84	90	121	121	146	146	154	163	180
Merchandise FOB	63	70	98	99	111	109	114	121	134
Imports of goods & services	130	132	164	183	203	243	269	299	328
Merchandise FOB	93	97	111	131	136	165	185	209	231
Resource balance	-47	-42	-43	-62	-57	-97	-115	-135	-148
Net current transfers	7	8	6	6	11	10	11	11	11
Current account balance (incl. grants)	17	18	43	18	39	38	19	7	3
Net foreign direct investment	0	0	0	0	0	1	2	2	3
Long-term loans (net)	6	3	11	12	-1	6	6	3	0
Official	8	5	13	14	2	6	5	3	0
Private	-2	-2	-2	-2	-2	0	0	0	0
Other capital (net, incl. errors & omissi)	-10	-6	-29	-8	7	-4	0	9	14
Change in reserves <sup>b</sup>	-13	-14	-25	-22	-45	-41	-26	-21	-20

(Continued)

## Bhutan - Key Economic Indicators (Continued)

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
<i>Memorandum items</i>									
Resource balance (% of GDP)	-17.6	-14.3	-13.0	-16.6	-13.7	-22.2	-24.6	-26.2	-26.1
Real annual growth rates (%)									
Merchandise exports (FOB)	..	..	..	..	..	..	..	..	..
Primary	..	..	..	..	..	..	..	..	..
Manufactures	..	..	..	..	..	..	..	..	..
Merchandise imports (CIF)	..	..	..	..	..	..	..	..	..
<b>Public finance (% of GDP)<sup>c</sup></b>									
Current revenues	21.2	20.3	19.6	18.5	19.9	19.3	19.8	19.9	20.6
Current expenditures	19.8	20.6	18.2	17.9	16.7	16.8	17.8	18.2	18.4
Current surplus (+) or deficit (-)	1.5	-0.3	1.5	0.6	3.3	2.5	2.0	1.8	2.2
Capital expenditure	20.6	18.8	21.1	20.0	14.0	18.2	19.3	19.7	19.9
Foreign financing	..	19.1	21.6	18.0	13.9	15.7	17.4	17.8	17.6
<b>Monetary indicators</b>									
M2/GDP	24.6	27.2	30.1	32.7	39.2	44.6	49.8	55.2	61.0
Growth of M2 (%)	21.5	29.9	30.4	30.9	41.7	30.0	29.0	28.0	28.0
Private sector credit growth / total credit g	..	..	..	..	..	..	..	..	..
<b>Price indices (1980 =100)</b>									
Merchandise export price index	..	..	..	..	..	..	..	..	..
Merchandise import price index	..	..	..	..	..	..	..	..	..
Merchandise terms of trade index	..	..	..	..	..	..	..	..	..
Real exchange rate (US\$/LCU) <sup>d</sup>	..	..	..	..	..	..	..	..	..
<b>Real Interest Rates</b>									
Consumer price index (% FY change)	5.9	8.2	9.3	7.4	9.0	9.2	7.0	7.0	7.0
GDP deflator (% CY change)	9.3	9.8	11.4	14.7	5.9	7.8	8.0	8.0	8.0

a. Includes net unrequited transfers excluding official capital grants.

b. Includes use of IMF resources. Note that a minus sign (-) indicates an increase in assets.

c. Refers to Consolidated Central Government accounts

d. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

Data on National Accounts and Debt is in calendar year; all other data is in fiscal year.

Due to large exchange rate devaluations in 1997 and 1998, there is a big jump in the 1999 GNP per capita projection.

## Bhutan - Key Exposure Indicators

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total debt outstanding and disbursed (TDO) (US\$m) <sup>a</sup>	105	106	114	121	120	126	131	134	134
Net disbursements (US\$m) <sup>a</sup>	6	3	11	12	(1)	6	5	3	0
Total debt service (TDS) (US\$m) <sup>a</sup>	8	10	7	7	9	7	7	7	7
Debt and debt service indicators (%)									
TDO/XGS <sup>b</sup>	124.9	117.3	94.4	99.5	82.0	85.9	85.3	81.8	74.3
TDO/GDP	38.6	33.3	33.4	29.8	28.0	28.2	26.6	24.8	22.5
TDS/XGS	9.0	10.9	5.8	5.9	6.4	5.0	4.6	4.3	3.8
Concessional/TDO	90.7	93.0	95.7	96.2	100.0	..	..	..	..
IBRD exposure indicators (%)									
IBRD DS/public DS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Preferred creditor DS/public DS (%) <sup>c</sup>	14.7	12.2	21.4	21.1	18.3	28.8	29.6	31.0	31.9
IBRD DS/XGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IBRD TDO (US\$m) <sup>d</sup>	0	0	0	0	0	0	0	0	0
Of which present value of guarantees (US\$m)	0	0	0	0	0	0	0	0	0
Share of IBRD portfolio (%)	..	..	..	..	..	..	..	..	..
IDA TDO (US\$m) <sup>d</sup>	21	23	23	23	24	25	29	33	36
IFC (US\$m)									
Loans	0	0	0	0	0	0	0	0	0
Equity and quasi-equity /c	0	0	0	0	0	0	0	0	0
MIGA									
MIGA guarantees (US\$m)	0	0	0	0	0	0	0	0	0

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

### Status of Bank Group Operations in Bhutan Operations Portfolio

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US\$ Millions				Difference Between expected and actual disbursements a/		Last PSR Supervision Rating b/																													
				IBRD	IDA	Cancel.	Undisb.	Orig	Frm Rev'd	Dev Obj	Imp Prog																												
Number of Closed Projects: 5																																							
<u>Active Projects</u>																																							
BT-PE-9582	1994	GOB	FORESTRY III	0.00	5.40	0.00	3.41	3.03	.89	S	S																												
BT-PE-9574	1998	ROYAL GOV'T OF BHUTAN	EDUCATION II	0.00	13.69	0.00	12.81	2.43	0.00	S	S																												
Total				0.00	19.09	0.00	16.22	5.46	.89																														
<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th style="text-align: center;"><u>Active Projects</u></th> <th style="text-align: center;"><u>Closed Projects</u></th> <th style="text-align: center;"><u>Total</u></th> </tr> </thead> <tbody> <tr> <td>Total Disbursed (IBRD and IDA):</td> <td style="text-align: right;">2.64</td> <td style="text-align: right;">21.00</td> <td style="text-align: right;">23.64</td> </tr> <tr> <td>  of which has been repaid:</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">.91</td> <td style="text-align: right;">.91</td> </tr> <tr> <td>Total now held by IBRD and IDA:</td> <td style="text-align: right;">19.09</td> <td style="text-align: right;">16.37</td> <td style="text-align: right;">35.46</td> </tr> <tr> <td>Amount sold :</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">0.00</td> </tr> <tr> <td>  Of which repaid :</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">0.00</td> </tr> <tr> <td>Total Undisbursed :</td> <td style="text-align: right;">16.22</td> <td style="text-align: right;">0.00</td> <td style="text-align: right;">16.22</td> </tr> </tbody> </table>													<u>Active Projects</u>	<u>Closed Projects</u>	<u>Total</u>	Total Disbursed (IBRD and IDA):	2.64	21.00	23.64	of which has been repaid:	0.00	.91	.91	Total now held by IBRD and IDA:	19.09	16.37	35.46	Amount sold :	0.00	0.00	0.00	Of which repaid :	0.00	0.00	0.00	Total Undisbursed :	16.22	0.00	16.22
	<u>Active Projects</u>	<u>Closed Projects</u>	<u>Total</u>																																				
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of which has been repaid:	0.00	.91	.91																																				
Total now held by IBRD and IDA:	19.09	16.37	35.46																																				
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Of which repaid :	0.00	0.00	0.00																																				
Total Undisbursed :	16.22	0.00	16.22																																				

- a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.  
b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

Note:  
Disbursement data is updated at the end of the first week of the month.

## Bhutan—CAS Summary of Development Priorities

<i>Network area</i>	<i>Country performance<sup>a</sup></i>	<i>Major issue<sup>b</sup></i>	<i>Country priority<sup>c</sup></i>	<i>Bank priority<sup>c</sup></i>	<i>Reconciliation of country and Bank priorities<sup>d</sup></i>
<b>Poverty Reduction &amp; Economic Management</b>					
• Poverty reduction	Good	Rural poverty	High	High	
• Economic policy	Excellent	Diversify econ.	High	High	
• Public sector	Good	Cap.building	High	High	
• Gender	Good	Women's participation in the formal sector	Moderate	Moderate	
<b>Human Development Department</b>					
• Education	Excellent	Basic educ.	High	High	
• Health, nutrition & population	Good	Improving quality of health care & pop. growth	High	High	
• Social protection	Good	Social inclusion of all groups	Moderate	High	Ongoing dialogue
<b>Environmentally &amp; Socially Sustainable Development</b>					
• Rural development	Fair	More rural access roads; agric. services	High	High	
• Environment	Excellent	Forest manag. & conserv.	High	High	
• Social development	Good	Decentral. & participation	High	Moderate	Other donors
<b>Finance, Private Sector &amp; Infrastructure</b>					
• Financial sector	Fair	Liberalization	Moderate	High	Ongoing dialogue
• Private sector	Fair	Privatization	Moderate	Moderate	
• Energy & mining	Good	Hydropower development	High	Moderate	Other donors
• Infrastructure	Good	Road maintenance, rural mobility & urban planning	High	High	

a. Use "excellent," "good," "fair," or "poor."

b. Indicate principal country-specific problems (e.g., for poverty reduction, "rural poverty;" for education, "female secondary completion;" for environment, "urban air pollution").

c. To indicate priority, use "low," "moderate," or "high."

d. Give explanation, if priorities do not agree; for example, another MDB may have the lead on the issue, or there may be ongoing dialogue.

**MAP SECTION**



