Dear Mr. Malpass,

This letter of Development Policy lays out the key elements of the Royal Government of Bhutan’s (RGoB) proposed policy and institutional reform program (“the program”) for the third programmatic Strengthening Fiscal Management and Private Sector Employment Opportunities Development Policy Credit (DPC III). The RGoB requests the assistance of the World Bank Group in the form of Development Policy Financing (DPF) for US$ 40 million. This financing will be used to support the reform areas articulated in the 12th Five-Year Plan (FYP) 2018-2023. The main objective of the 12th FYP is to achieve a “just, harmonious and sustainable society through enhanced decentralization”. The assistance from the World Bank Group is needed to especially support the RGoB’s efforts to improve fiscal sustainability and to strengthen private sector employment opportunities in the country.

The Royal Government of Bhutan would like to thank the International Development Association for providing extensive support through the DPF instrument in the past. Starting with a Development Policy Grant in FY2006, Bhutan has benefited from the use of the DPF instrument in FY2007, FY2009, FY2012, FY2016, FY2018 and FY2019. All these operations have helped deepen policy and institutional reforms in the country and were deeply embedded in our respective Five-Year Plans. As a result, Bhutan made significant progress to achieve the MDGs and reduce poverty from 12 percent in 2012 to 8.2 percent in 2017. The Royal Government of Bhutan also remains committed to realize its Vision 2020 as well as the Sustainable Development Goals (SDGs) by 2030.

The RGoB requests continuing World Bank support through the proposed DPC III to support institutional strengthening in some key areas. Building on the momentum and the lessons learned from the past DPF operations, the RGoB believes that the instrument is highly useful in facilitating development in Bhutan and to enable the World Bank Group in achieving its own twin goals of reducing poverty and boosting shared prosperity across its member countries. The RGoB requests selective support for the goals and strategies under the 12th FYP and is committed to implement the institutional and policy reforms described in the policy and results matrix. The following two broad
thematic areas are being addressed in this DPC series: (A) Improving Fiscal Sustainability and (B) Strengthening Private Sector Employment Opportunities.

(A) Improving Fiscal Sustainability

Improving fiscal sustainability is one of the overarching objectives of the 12th FYP. Despite sustained economic growth, Bhutan has been exposed to macroeconomic vulnerabilities during the last several years. In order to address these vulnerabilities and to smoothen public consumption, the RGoB has established a Stabilization Fund for which it has adopted rules and regulations that aim to implement counter-cyclical fiscal policies that reduce fluctuations in aggregate demand and build fiscal buffers. Furthermore, to improve fiscal responsibility and supplement efforts to increase self-reliance, the RGoB will take steps to broaden the tax base, including through the introduction of a new Goods and Services Tax (GST) supported by DPC III. The introduction of the GST will improve efficiency in tax collection along with an increase in the collection of domestic revenues. The government remains committed to moving forward with this reform and expects its implementation to start from July 2020. The RGoB also believes that improved guidelines for hydro projects will help reduce fiscal costs. Accordingly, the RGoB has approved the guidelines for hydropower investments to support growth and contain fiscal costs.

Further, the RGoB believes that improved Public Financial Management (PFM) systems will help to improve the quality of public spending in the country. With that in mind, the RGoB has approved the PFM Reform Strategy. To complement the objectives of the new PFM Reform Strategy, the RGoB, with support from the DPC II operation, has approved the amended Public Procurement Rules to improve public procurement systems and has rolled out an electronic Public Expenditure Management System (e-PEMS) in July 2019 to improve the efficiency in the overall government financial management and the payment services to all the RGoB clients. Further, to support greater efficiency, transparency and accountability, with the ultimate aim of improving the quality of spending, the government is working towards an integrated public financial management system by establishing interconnectivity between existing and new PFM information systems. In addition, the Government has also adopted cash-based International Public Sector Accounting Standards (IPSAS) for the preparation of the 2019/20 Annual Financial Statements, which is expected to improve the transparency, reliability, comparability and consistency of public financial reporting.
B) Strengthening Private Sector Employment Opportunities

The RGoB continues to play a key role in the economic development of the country as the private sector remains relatively small and underdeveloped. In order to boost the role of the private sector, the 12th FYP places great emphasis on economic diversification, skill development, access to finance and sustainable and inclusive development. These form part of the 17 National Key Results Areas of the 12th Five Year Plan which greatly emphasizes the development of the non-hydropower sector by fostering the growth of a dynamic private sector and thereby catalyzing the transition to green and resilient development. As you might be aware, as the only carbon negative country in the world, Bhutan incorporates climate change initiatives within our development planning framework.

The RGoB, supported by the DPC series, has also taken steps to improve access to finance and skills development in the country. Implementation of the legal reforms supported by DPC I and II which aimed to improve the financial infrastructure (credit information bureau, and Global Interchange and Financial Transactions system) and strengthen the legal rights of creditors and borrowers has helped in addressing constraints to accessing financing. Building on these reforms, the RGoB has approved the revised FDI Policy to ease and harmonize equity restrictions. Further, the government has approved the National Competition Policy to promote a market-based economy, driven by fair and healthy competition, with no entry barriers for new enterprises, preventing commercial monopolies and oligopolies from abusing their market power. In addition, the Royal Monetary Authority has adopted the oversight and supervision framework for the National Payments System to promote the safety and efficiency of the payment and settlement systems through effective monitoring and control mechanism.

The DPC III operation also supports further reforms in the education and health sectors which will eventually help build skills and human capital to enhance and promote private sector employment opportunities. To improve education outcomes and enhance skills, the RGoB has developed and approved the Bhutan Professional Standards for Teachers to improve teacher quality which has an impact on learning outcomes. To build on the approval of the Accelerating Maternal and Child Health Program (AMCHP), supported by DPC II, an Operations Manual has been approved to provide detailed guidelines to implementers of the AMCHP at centralized and decentralized levels. This action will help provide quality maternal and child healthcare, leading to healthier citizens and enabling them to realize their potential as productive members of society. The Government considers investing in human capital as key to creating more inclusive societies and ending extreme poverty.

As highlighted above, the RGoB strongly believes in an economic growth trajectory that is sustainable and inclusive. While Bhutan’s policy planning process naturally incorporates assessments
of climate change impacts, the Economic Development Policy (2016) emphasizes that energy efficiency and conservation measures are institutionalized and promoted. To support this, the Government has approved the National Energy Efficiency and Conservation Policy to encourage general improvements in the energy performance standards of the major economic sectors. The RGoB has further approved the National Climate Change Policy to put in place measures to help Bhutan adapt to and mitigate effects of climate change. In addition, the Government has adopted the National Gender Equality Policy and the Standard Operating Procedures for the Prevention of Gender-Based Violence to provide a coherent strategic framework of the government’s priority towards gender equality and to prevent gender-based violence. These actions will help support efforts to implement inclusive economic growth by creating an ecosystem that allows women’s participation in both formal and informal segments of the economy.

Conclusion

The RGoB remains highly committed to our reform progress supported by the proposed DPC III, as part of the programmatic DPC series. We would like to express our appreciation for the support and the assistance extended by the World Bank Group to Bhutan’s socio-economic development. We look forward to continued support and fruitful collaboration in the years to come.

Yours sincerely,

Namgay Tshering
FINANCE MINISTER