

## **World Bank Group Bhutan Country Partnership Framework**

### **Summary Note**

The World Bank Group (WBG) has been partnering with Bhutan for more than 35 years supporting the Government's priorities to improve the livelihoods and create opportunities for the people of Bhutan.

The WBG partnership with Bhutan has been fully aligned with the country's development vision articulated in the Constitution, Bhutan Vision 2020, and the 12th five-year plan (FYP). The partnership is articulated in the WBG's Country Partnership Strategy (CPS) for FY2015-2019. The CPS has organized its activities under three results areas: (a) improving fiscal and spending efficiency; (b) increasing private sector growth and competitiveness; and (c) supporting green development.

The World Bank Group have made notable progress under the last CPS; supported the government reforms to increase revenues, lower deficit, and strengthen public financial management and procurement systems (Results Area a). The adoption of the 2016 Debt Policy has been instrumental in strengthening debt management to ensure fiscal sustainability. To strengthen fiscal management, the creation of a stabilization fund would manage large inflows from the hydropower sector. The CPS program influenced government policies in improving efficiency of financial services and streamlining institutional process for improved business environment (Results Area b). Domestic investment also increased, creating further employment opportunities. The revised 2019 foreign direct investment (FDI) policy is expected to enable investors to have faster approvals and will allow a minimum investment size. However, progress in these areas has not yet been fully translated into increased private sector development.

The World Bank Group supported the promotion of improved irrigation and agroeconomic practices and rehabilitation of productive assets (Result Area c). Despite implementation challenges, the program helped increase agriculture productivity in key commodities such as paddy. Access to urban infrastructure improved and also led to increased revenue generation for Thimphu municipality. IFC's first public-private partnership (PPP) concession for Thimphu City parking facilities is a significant milestone for Bhutan's further engagement with the private sector. The World Bank's strong partnership through various grant mechanisms enabled the government to mainstream biodiversity conservation into national planning, which is highly relevant for improving the management of natural capital and resilience to the impacts of climate change.

However, there are still emerging challenges Bhutan faces in continuing its development path. The recent household survey shows persistent disparities between urban and rural areas and between women and men persist. Poverty rates vary widely by district, and over 90 percent of the poor live in rural areas. They are also much less educated and primarily work in subsistence agriculture, with few opportunities for nonfarm diversification. The country is urbanizing fast, but with its mountainous terrain, agglomeration economies are limited. The country is entering a period of demographic dividend; yet unemployment has increased in recent years. With their inherent risks from macroeconomic volatilities and climatic shocks, overreliance of hydropower will make the economy highly vulnerable to such risks.

Natural resources continue to provide unique opportunities for Bhutan's growth. Hydropower generation will continue to be the main engine of growth for any foreseeable future, providing a stable channel of foreign exchanges and revenues to the Government. The country needs to

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manage its risks by building climate resilience and improving efficiency in public finance, including competitiveness of state-owned enterprises (SOEs). As the only carbon-negative country in the world with forest coverage exceeding 70 percent of national land, Bhutan is well positioned to benefit from carbon finance.

The country also needs to broaden its economic opportunities to address the rising challenges to its inclusive growth. As the public sector can no longer fully absorb the expanding and increasingly educated labor force, the challenge for the country is how best to establish conditions for private sector in non-hydro sectors to generate more jobs, particularly for youth and in rural areas. Structural reforms are needed to create incentives for private sector investments, including in the sectors of high potentials for job creation such as agribusiness and tourism. Further investments in human capital, particularly in rural areas, is important to attain more equitable growth today. Investments in transport and digital connectivity will reduce cost of service delivery and facilitate private sector investments and job creation.

The primary goal of this CPF is therefore, to support Bhutan to achieve equitable development by closing the current welfare gaps particularly in rural areas and by investing in long-term inclusive growth through job creation, particularly among youth, with private sector development.

The CPF takes a two-pronged approach:

(i) First, by helping the country build more resilient and equitable economy based on its traditional resource-based growth such as managing climatic risks, maintaining macroeconomic and fiscal stability, including efficiency in public finance and competitiveness of SOEs, and strengthen service delivery in underserved areas such as rural areas and for the vulnerable population.

while at the same time;

(ii) by supporting the country's long-term agenda of job creation through human capital investments and economic diversification with broader private sector participation, particularly for youth.

The CPF builds on the findings from the FY20 Systematic Country Diagnostic, the WBG Country Opinion Survey of 2018 and is fully congruent to the Government's 12<sup>th</sup> Five Year Plan, adopted in January 2019.