

ASIAN DEVELOPMENT BANK

**COUNTRY ASSISTANCE PLAN
(2000-2002)**

BHUTAN

December 1999

FOREWORD

The Country Assistance Plan describes the planned program of assistance by the Asian Development Bank (ADB) for Bhutan covering the three-year period 2000-2002. It includes loan and technical assistance projects, as well as possible cofinancing from other donors. The CAP was prepared by the ADB between April and June 1999, in close consultation with the Government of Bhutan, and other stakeholders, including non-government organizations. The CAP was discussed with the Board of Directors in October 1999. The assistance plan described in the CAP is only indicative and may be revised to reflect more recent developments.

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CURRENCY EQUIVALENTS

(as of 30 November 1999)

| | | |
|---------------|---|---------------|
| Currency Unit | – | Ngultrum (Nu) |
| Nu1.00 | = | \$0.0230 |
| \$1.00 | = | Nu43.40 |

The Bhutanese ngultrum is pegged to the Indian rupee at par.

ABBREVIATIONS

| | | |
|--------|---|---|
| ADB | - | Asian Development Bank |
| ADF | - | Asian Development Fund |
| ADTA | - | advisory technical assistance |
| BDFC | - | Bhutan Development Finance Corporation |
| BNB | - | Bhutan National Bank |
| COS | - | country operational strategy |
| DOP | - | Division of Power |
| DOR | - | Division of Roads |
| EIA | - | environmental impact assessment |
| FY | - | fiscal year |
| GDP | - | gross domestic product |
| GEF | - | Global Environment Facility |
| IFAD | - | International Fund for Agricultural Development |
| IMF | - | International Monetary Fund |
| JICA | - | Japan International Cooperation Agency |
| NBACD | - | National Budget and Aid Coordination Division |
| NEC | - | National Environment Commission |
| OCR | - | ordinary capital resources |
| PPTA | - | project preparatory technical assistance |
| RIM | - | Royal Institute of Management |
| RMA | - | Royal Monetary Authority |
| RSEB | - | Royal Securities Exchange of Bhutan |
| TA | - | technical assistance |
| UNCDF | - | United Nations Capital Development Fund |
| UNDP | - | United Nations Development Programme |
| UNFPA | - | United Nations Population Fund |
| UNICEF | - | United Nations Children's Fund |

NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June.
- (ii) In this report, "\$" refers to US dollars.

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BHUTAN

I. Country Performance Assessment

A. Economic Performance Assessment¹

1. Bhutan was virtually isolated from the rest of the world prior to the early 1960s, with an economy based on subsistence agriculture. While efforts under a series of five-year plans helped establish basic infrastructure in the economy, it was not until the 1980s with the commissioning of the Chukha hydropower plant that a diverse economy really began to emerge. With the advent of hydropower in the country—and the manufacturing enterprises benefiting from low-cost power—growth of gross domestic product (GDP) in the late 1980s reached nearly 8 percent per year. With no large projects coming onstream, industrial growth in Bhutan has slowed in recent years, but the country still maintains GDP growth rates in excess of 5 percent. The Eighth Five-Year Plan, FY1998-FY2002 (Eighth Plan) projects average annual GDP growth of 6.5 percent during the plan period and about 5.5 percent during the first two years of the plan. Although overall growth in the economy is currently on track to achieve the Eighth Plan's goals, inadequate physical infrastructure including lack of an efficient road network to markets remains a major constraint to further development of the country in the longer term.

2. Agriculture historically has been the slowest growth sector. However, its importance to the economy cannot be understated. The Government estimates that 85 percent of the population reside in rural areas even though only 8 percent of the country's land area is under cultivation. Maize and rice are the primary foodgrains cultivated, accounting for 62 percent of the total area planted to annual crops. Tree crops occupy a much smaller area of cultivation than foodgrains, but have become important in international trade nonetheless. Apples and oranges in particular have been key sources of convertible currency earnings in recent years. Within the agriculture sector, the forestry and livestock subsectors have outperformed agriculture proper throughout the 1990s despite environment-based restrictions on mass logging and the number of cattle reared.

3. Growth in the industrial sector has slowed considerably in recent years with the slower growth in electricity and manufacturing. This sector is dominated by a small number of state-owned or formerly state-owned firms. As a result, a single firm or a large new enterprise can cause large jumps in the growth rates. Manufacturing and electricity owe much of their existence to public industrial development, but the Government has made considerable progress toward privatizing its manufacturing holdings. At this point, the bulk of manufacturing output and exports is from a narrow range of products—such as cement, ferro-alloys, and calcium carbide—the production of which rely heavily on the use of electricity. The Dungsum cement project currently under construction will boost manufacturing production but will also reinforce the sector's dependence on a limited number of goods.

4. The commissioning of the first stage of the Chukha hydroelectric plant in 1986 allowed Bhutan to begin exploiting its comparative advantage in hydropower production. With its capacity of 336 megawatts (MW), Chukha makes up more than 95 percent of the country's

¹ Appendix 1 (Country Performance Indicators) provides information on key economic, social, and environmental indicators.

installed electricity generating capacity. Therefore, changes in the electricity sector are dominated by factors affecting Chukha and its export of surplus energy to India. For the most part, annual power generated from Chukha has been relatively constant. Modifications in 1992 and 1995 allowed for an increase in the quantity of power produced, but the story of Chukha's impact on the domestic economy lies in the price charged for its output. When the Government of India agreed to build the plant (mainly with grant financing), the price for electricity exports was set well below prevailing rates in India as well as in the region at Nu0.19 per kilowatt-hour (kWh). The export price was increased to Nu0.27 per kWh in 1990, Nu0.37 in 1993, Nu0.50 in 1995, Nu1.00 in 1997, and to its current rate of Nu1.50 per kWh in July 1999. The price charged to domestic consumers has also been rising over time, but at a much slower rate.

5. Bhutan is proceeding cautiously on its course of structural transformation. By 1998, the share of agriculture in the economy had dropped to 38 percent, compared to the 46 percent share in the late 1980s. In the same year, industry's share of production had nearly equaled that of agriculture. These figures mask the fact that industry is still dominated by only a handful of firms in a limited number of sectors. The new cement plant and hydropower projects scheduled to begin operation in the next few years will reinforce the dominance of these sectors in industrial production. Institutional changes to promote private sector development (including regulations on foreign direct investment) are currently under discussion by the Government. Removing the impediments to private sector development may help to diversify the industrial structure of the economy and lessen the need for industrial projects initiated by the public sector. However, any regulatory changes will be balanced against the Government's strong commitment to preserving Bhutan's unique environment and culture.

6. The Government has continued to pursue prudent fiscal policy, achieving an overall budget surplus of more than 3 percent of GDP in FY1998. Corporate taxes and profit transfers from the Chukha hydropower plant are the Government's main source of revenues, accounting for 41 percent of current revenues. Preparations for introducing a personal income tax are underway, although the timing for its implementation has not yet been announced.² Current expenditures have declined gradually as a percentage of GDP despite the continuing expansion of health and education services and the 25 percent increase in civil service salaries in FY1997 and further increase of 20 percent in FY1998. The fall in capital expenditures (from 18 percent to 13 percent of GDP) and grants (from 18 percent to 15 percent of GDP) mainly reflects delays in negotiating financing from the Government of India at the beginning of the Eighth Plan. As the financing terms and conditions have been resolved, capital expenditures and grants are expected to return to the levels of previous years.

7. Government expenditures for FY1999 ended 3 percent higher than originally envisaged. However, this was offset by the increase in domestic revenues, which rose by 13 percent more than the original estimate. Domestic revenue amounting to Nu3.5 billion more than covered the current expenditure of Nu3 billion. For the third consecutive year, the Government has met its objective of covering all current expenditures by domestic revenues. The new budget for FY2000 projects a 10 percent increase in expenditure, with a large part of the increase being accounted for by a 20 percent increase in the remuneration of government personnel. Nevertheless, domestic revenues are expected to more than cover this increase, exceeding the current expenditure level by 8.3 percent. Health and education will receive the

² A personal income tax was planned to be introduced in January of year 2000. However, it was felt that more time is needed to complete the necessary preparations.

highest allocation at 26 percent, followed by energy (12.7 percent), communications (11 percent), and agriculture (9.1 percent).

8. The scope for monetary policy in Bhutan is limited because of the fixed exchange rate arrangement and the large quantity of Indian currency circulating freely in the economy. Broad money supply (M2) grew by 42 percent in FY1998, due to the inflow of foreign exchange mainly from aid, continuing the trend of accelerating money growth. This did not translate into high inflation because of the increasing demand for money with the progressive monetization of the economy. Inflation in FY1998 rose from 7 percent in FY1997 to 9 percent following rising food prices. Inflation is expected to further increase in the current fiscal year following further increases in food prices in India.

9. The dollar value of merchandise exports grew by 12 percent in FY1998 while merchandise imports grew by less than 4 percent, leading to a decline in both the trade deficit and the current account deficit. The Government has been restrictive in its policy towards tourism to protect Bhutan's environment and preserve the country's unique culture and traditions. Nevertheless, tourist arrivals increased from 1,500 in 1990 to over 6,000 in 1998. Recently, the Government has adopted measures to further exploit the potential of tourism. The \$200-per-day fixed rate for every visitor was lowered to \$150 during the off-season, and the ceiling on the number of tour operators was removed early this year. Capital inflows have more than covered the current account deficit.

10. Both the debt-to-GDP ratio and the debt service ratio have improved in recent years, due mostly to declines in nonconvertible currency debt. The budget document emphasizes that the Government "will continue to exercise extreme caution in availing of additional loans." Currently, the debt service ratio stands at around 9 percent, with total outstanding external debt in convertible currency amounting to \$97 million and rupee debt outstanding Rs788 million (about \$18 million). These figures compare favorably with a level of gross national reserves amounting to \$280 million, equivalent to more than 20 months of imports. As more of the grace periods expire on the concessional debts that Bhutan acquired in the 1980s, the country's debt-service capacity will come under increasing pressure.

11. The medium-term prospects for Bhutan are quite favorable. Even under relatively conservative assumptions about sectoral performance, the country should achieve 5 percent growth in real output per year with potential for higher rates as the power plants currently under construction are completed. The expansion of the power sector also has positive implications for the government budget and balance-of-payments position. However, the country's dependence on energy exports and foreign assistance is a matter of concern, as small changes in either of these areas could destabilize the economy. For energy exports, Bhutan is a small supplier to a single large market: India. This asymmetric relationship limits the country's ability to negotiate price increases and leaves it exposed to shocks in the Indian economy. For foreign assistance, changes in policy that are minor from the funding agencies' point of view are magnified in the Bhutanese context. These risks point to the need for the country to broaden its sources of revenue. On the fiscal side, the Government should look for ways to broaden the tax base and improve cost recovery. On the production side, the Government needs to facilitate diversification of the industrial base by providing an environment conducive to private sector development.

12. A large share of Bhutan's population is below 15 years of age, and this young cohort has better access to education than previous generations. A major challenge for the medium

term is how to generate productive employment for these workers. The private sector can remove some of the burden of job creation from the Government, but the latter needs to further improve the enabling environment for private sector development.

13. The 77th session of the National Assembly concluded on 4 August 1999 during which several important bills were passed, including Telecommunications Act, Road Safety and Transport Act, Bankruptcy Act, Immovable and Movable Property Act, and Municipal Act. These Acts are expected to strengthen the legal framework for a market-oriented economy as well as the capacity of the central and local government units to manage development on a sustainable basis. Under a new system of government, the King remains the Head of State, but he is no longer the Head of Government. The latter position is now being rotated among members of the Cabinet of Ministers (six of them) on an annual basis. The present Head of Government is Lyonpo Sangay Ngedup, Minister of Health and Education.

B. Assessment of Socio-Environmental Performance

1. Poverty Issues

14. Bhutan's per capita gross national product (GNP) is approximately \$480 (1997), and the country ranks 145th among 174 countries in the United Nations Development Programme's (UNDP) 1997 human development index (HDI), published in 1999.³ This is better than its 1990 HDI rank of 159. Although Bhutan remains a least developed country under UN classification, poverty does not take the shape of abject poverty seen in several other South Asian countries.⁴

15. Reliable data on income poverty are not available. A large segment of the population still depends on subsistence agriculture. On average, more than 60 percent of household expenditure accounts for food and beverages. The major constraint is the mountainous and landlocked environment compounded by lack of access to markets, which makes it difficult to create viable employment opportunities for the poor. Without adequate cash income earning opportunities, goods and services become unaffordable to villagers. Life in the mountains is harsh. The limited road network also forces long distance travel to receive adequate and proper health care and education services. There are wide variations in average household income and expenditure by geographical areas. According to the 1992 Household Income and Consumption Expenditure Survey (published in 1994), the top 10 percent of households receive 36 percent of total income, while the bottom 50 percent receives only 13 percent. The Gini coefficient at 0.563 indicates income inequality is high. Due to the lack of data on income poverty, the issue has to be examined in the context of non-income dimensions of poverty.

³ GNP per capita for Bhutan is calculated based on the official population estimate of 600,000 (1996) and population growth estimated at 3.1 percent per annum, which is different from the latest United Nations (UN) estimate of 1.86 million (1997). HDI is based on UN estimates. A population census under the assistance of United Nations Population Fund (UNFPA) is being planned for 2000 to resolve the issue (see also para. 20).

⁴ ADB is currently preparing a social sector profile for Bhutan, which includes an assessment of poverty reduction.

2. Gender Issues

16. Women in Bhutan play a major role in the development of the country. They are actively involved in all areas of economic, political and social life as farmers, entrepreneurs, decision-makers, doctors, engineers, and homemakers. About sixty-two percent of women are involved in agriculture and 16 percent participate in other economic activities. Bhutanese women do not suffer from gender discrimination as they have equal status with men and enjoy the same level of freedom under the laws of the country. In fact, the predominant inheritance laws are particularly favorable to women. Their participation in decision making at grassroots levels such as community meetings is estimated at about 70 percent. Participation of women in other decision-making bodies such as district and block level development committees is increasing and being actively pursued. Positions in the higher levels of government and decision making, in which women are not yet adequately represented, are open to both genders. Placement of women at the middle and lower levels of the civil service has increased significantly. In particular, the increase in women's representation in the National Assembly has provided a very conducive environment for enhanced integration of women in the socio-economic development of the country.

17. Social indicators for women have improved over the decades. The maternal mortality rate at 380 per 100,000 live births in 1994 has been reduced from 770 per 100,000 live births in 1984. The National Women's Association of Bhutan, which is the only nongovernment organization (NGO) for women, was established in 1981 to enhance the role of women at all stages of the development process. Total fertility at 5.6 is, however, very high in comparison with neighboring countries. While it is difficult to assess the exact situation due to lack of gender-disaggregated data, gender disparity does exist in educational attainment. For instance, the female adult literacy rate is half of that for males, although gender disparity in primary school attendance has substantially improved to a boy/girl ratio of 80:60 in 1996 from 40:19 in 1990. The Government is also addressing the problem of adult literacy through nonformal education, in which 70 percent of participants are reportedly women.

3. Human Development

18. Human development indicators in Bhutan have shown substantial improvement.⁵ Life expectancy increased from 48 years in 1984 to 66 in 1994. Infant mortality rate has halved from 142 to 71 per 1,000 live births while under-5 mortality rate has fallen from 162 to 97 per 1,000 live births. From 1987 to 1995, the percentage of the rural population with access to safe water supply increased from 31 percent to 58 percent and is projected to reach 80 percent within the next five years. Adult literacy rate has increased from an estimated 23 percent in 1980 to 38 percent in 1990 and to nearly 50 percent in 1996. However, some social indicators require considerable improvement, e.g., much remains to be done to reduce the total fertility rate, infant mortality rate, and child malnutrition rate. Although 85 percent of the total population live in rural areas, current population growth is more than 5 percent per year in the two cities of Thimphu and Phuentsholing. The pressure of population growth on existing urban areas is beginning to have negative impacts on urbanization as well as inadequate infrastructure and services.

19. Primary school enrollment has increased significantly from 12 percent in 1980 to 25 percent in 1990 and 72 percent in 1998, with female students now accounting for about 43

⁵ A social sector profile for Bhutan is currently being prepared by ADB to assess the development and constraints to further improve these indicators.

percent of the total. These figures reflect the Government's keen interest to develop human resources. The Eighth Plan aims to achieve a national gross primary enrollment ratio of 95 percent by the year 2002. Public education and health expenditure at 5.3 and 4 percent of GDP, respectively, are much higher than in neighboring countries. However, the acute shortage of trained and skilled personnel continues to be a major constraint. The Government is addressing these issues in the Human Resources Development (HRD) Master Plan covering 1997-2002. The HRD Master Plan identifies the requirements for HRD to achieve respective sectoral objectives in all sectors relevant to the civil service, and the private sector. Emphasis will be placed on providing short-term technical, vocational, and professional courses in the country, selective fellowship and graduate degree training overseas, and on strengthening the capabilities of institutions responsible for HRD including the education system; in-country technical, vocation, and professional training institutions; the Royal Civil Service Commission; the Career Counseling Service; and private sector organizations such as the Bhutan Chamber of Commerce.

20. The population growth rate at 3.1 percent, which will double the current population in 23 years, is alarmingly high. The significant decline in mortality rate has not been matched by a fall in fertility. The overall fertility rate is high at 5.6. With 43 percent of the population being below the age of 15, there is substantial momentum for population growth. Accordingly, the Eighth Plan accords high priority to population planning activities. The Government is taking necessary actions to promote smaller family size with full endorsement from the King. Donor agencies like the United Nations Population Fund (UNFPA), World Health Organization (WHO), and United Nations Children's Fund (UNICEF) are providing substantial assistance focusing on reproductive health care, family planning, and improvement of population data and information system in the country. The Government aims to achieve a population growth of 2 percent by the end of the Eighth Plan and a replacement rate of 2 surviving children per woman by the year 2012 by (i) increasing the contraceptive prevalence rate; (ii) raising the levels of education, especially for girls; and (iii) creating productive employment and increasing economic security. A population census is planned for 2000. Necessary training for the census is currently being undertaken through the assistance of UNFPA in consultation with the Ministry of Home Affairs.

4. Environment

21. Bhutan's environment management is highly regarded for preserving the Himalayan ecology and keeping the annual deforestation rate under 1 percent. Bhutan is probably the only country in the world where forest cover has increased over time (from 67 percent in 1990 to 72 percent in 1997). National protected areas also gradually increased to 26 percent in 1997.

22. Although Bhutan still has a rich and largely intact natural resource base, environmental problems are recently emerging, such as soil erosion, land degradation, and urbanization (due to inadequate solid waste and sewage disposal system and infrastructure and services). The Government, recognizing the need to achieve sustainable development, established the National Environment Commission (NEC) in 1989 with a broad mandate in environmental planning and management, which includes: (i) preparation of the National Environment Strategy completed in 1998; (ii) preparation of basic environmental policies and plans; (iii) establishment of an effective environmental impact assessment (EIA) system; and (iv) introduction of regulations, standards, and administrative procedures to effectively control pollution, preserve natural resources, and achieve sustainable development.

23. In recent years, the Government⁶ has undertaken a number of activities including, inter alia, the preparation of (i) the National Environment Strategy; (ii) a program for institutionalizing and strengthening the overall environmental assessment process in the country; (iii) EIA guidelines and procedures; (iv) environmental screening guidelines for major sectors; and (v) selected environmental quality criteria/standards. In addition, a program of technical and administrative training for the public and private sectors on the EIA process and implementation procedures was started through a series of workshops and training sessions. A human resources plan for NEC and relevant line ministries was also prepared. Finally, with regard to environmental legislation, the Forest and Nature Conservation Act was approved in 1995, and an EIA act has just been approved. Various line agencies are also in the process of revising rules and regulations in their areas of responsibility to incorporate different environmental requirements, including EIA procedures.

C. Governance: Sound Development Management

24. Bhutan accords high priority to the development of institutions and innovative systems of governance and deserves appreciation for its efforts towards good governance. The civil service is dedicated and conscientious. Ministers⁷ are generally from the civil service and show a high level of competence and professionalism. The Government is relatively small, but effective in many ways. There is little corruption in the country. In the limited instances where this has taken place, corrective and punitive actions have been swift. Moreover, discussion of policy and governance issues—including politically sensitive issues—can be conducted in an open and frank manner. Following the consultation process conducted by the King in all districts in relation to the implementation of the Eighth Plan last year, the Council of Ministers have recently initiated a free and frank exchange with the public to ensure that their views are appropriately reflected in the process of governance.

25. Development efforts in Bhutan have been an “inclusive” process, involving extensive participation of all segments of society. The approach to development has also emphasized the importance of institutions that can guide the process of development and deliver services to the people efficiently and effectively. The most recent example of this approach is the reconstitution of the Planning Commission to increase its effectiveness in planning, coordinating, and monitoring and evaluating the country’s development efforts. High priority has also been placed on decentralized systems of decision making. District and block development committees serve as forums, which link local communities to the process of decision making at the national level. These have enabled remote and isolated areas in Bhutan to become part of mainstream social and economic development, and have reinforced elements of responsibility and accountability in development management.

26. Another recent attempt to pursue good government includes concerted efforts to prevent corruption. A series of public seminars has been organized to raise awareness of the people of different forms of corruption particularly the nature of the problem in the country, control mechanisms, and preventive measures. These efforts also advocate the need to focus on people and to recognize that the Ministries of Finance and Trade and Industry, the media,

⁶ In particular, NEC and the Forestry Services Division (FSD) of the Ministry of Agriculture.

⁷ Cabinet ministers are no longer appointed by the King but elected by the National Assembly of Bhutan, the nation’s highest legislative body, with the first election conducted during the 76th session in July 1998. The King has also empowered the Cabinet to remove him from office with a vote of no confidence.

the judiciary, the education system, the business community, and the Royal Audit Authority, play important roles in curbing unethical and irregular practices. The themes for this year's commemoration of the King's 25-year reign—efficiency and effectiveness in governance, prevention of corruption in Bhutanese society, and the upliftment of the moral of civil servants—further indicate the Government's commitment to good governance.

27. The introduction of television and internet in Bhutan in June 1999 is a significant leap in the field of information and communication, which can help in promoting transparency and facilitating participation.

D. Implementation Assessment

1. The Portfolio

28. Asian Development Bank (ADB) operations in Bhutan started in 1983. As of December 1998, ADB had provided 14 loans totaling \$65.2 million and 61 technical assistance (TA) projects (43 advisory and 18 project preparatory) in an amount of \$22.3 million. During 1998, one loan was approved and one loan was closed. The loan approved in 1998 was declared effective on 17 March 1999. Bhutan began 1999 with five ongoing loans totaling \$26.6 million in the portfolio (see Appendix 2). With the approval of 4 new TAs during 1998, there are now 11 ongoing TAs amounting to \$5.55 million. In terms of project performance classification, all ongoing loans are classified as satisfactory in both implementation progress and achieving development objectives. In 1998, \$3.2 million contract awards and \$4.3 million disbursements were achieved, representing a 77 percent and 99 percent achievement rate, respectively. Moreover, Bhutan's disbursement ratio of 33.1 percent in 1998 compares favorably with 20.1 percent for all ADF⁸ countries.

29. At the beginning of 1999, the overall undisbursed loan amount in the portfolio was \$15.05 million out of \$26.6 million, about 57 percent of net effective loan amount. This reflects a "younger" portfolio compared with less than 35 percent of net effective loan amount at the beginning of 1998. It is, nevertheless, considered manageable. The current portfolio supports a balanced transition towards a modern economy with strong emphasis on institutional development and capacity building to support further development in energy, road transport, urban infrastructure, finance, and human development.

30. Although ADB's operations in Bhutan have been modest, its investments have made significant impact in supporting the country's development efforts. To diversify the economy from a totally agrarian society, the country has had to deal with a severe shortage in skilled manpower and weak infrastructure. Most of the technical personnel in the country had been trained in India and/or other countries. The establishment of the Royal Institute of Management (RIM) in Thimphu (established with ADB assistance) is the only institution in the country offering courses to produce graduates in commercial and business fields. ADB assistance in the rehabilitation and maintenance of the East-West Highway has enhanced linkages between economic opportunities and potential markets.

31. ADB, in close coordination with the International Monetary Fund (IMF), has been instrumental in helping develop the financial sector and in facilitating further expansion of private sector activities. ADB assisted in the conversion of the Unit Trust of Bhutan to a second

⁸ Asian Development Fund, ADB's soft-lending window.

commercial bank in the country. Its emergence has already brought healthy competition in commercial banking in terms of a better and wider range of financial services. The Government is implementing the first ever policy-based program loan from ADB to modernize the business environment through liberalization of interest rates and reform of financial, industrial, and trade policies. Interest rate ceilings have for the most part been deregulated and requirements for setting up business undertakings have been reduced and simplified.

32. Three loans have been postevaluated with one unsuccessful, one generally successful, and one partly successful. The unsuccessful multiproject loan, which was the first ADB loan to Bhutan, suffered from too many subprojects in different sectors as well as other implementation problems. Out of six subprojects under the loan, only four met their objectives. The Highland Livestock Development was rated generally successful. The project has contributed to increased production especially in milk output, and farmers' income more than doubled in nominal terms. The credit line to Bhutan Development Finance Corporation (BDFC) was rated partly successful. The project provided foreign exchange financing to industry, and broadened the industrial/business base, which in turn helped create jobs, supported ancillary business, introduced new technology to Bhutan, and provided foreign exchange earnings/savings. However, BDFC failed to attract sufficient private sector investment as envisaged during project formulation and to develop into an efficient development finance institution. BDFC continues to rely on capital injection from the Government from time to time, including the recent issuance of government bonds amounting to Nu50 million.

33. A postevaluation report was also prepared for four TAs provided to the National Budget and Aid Coordination Division (NBACD) to enhance its capabilities in budgeting and external resource management. ADB assistance was able to substantially improve efficiency in day-to-day operations through computerization of budget accounting and external resource management. However, these TAs were rated partly successful only because the TAs did not fully develop the necessary institutional capacity to sustain and effectively undertake public expenditure management. Under UNDP's assistance, the Government has prepared a development framework for effective aid coordination and identified requirements in terms of necessary human resources and institution development. ADB will support these efforts through an advisory technical assistance (ADTA) in Public Sector Resources Management in 2000.

2. Issues in Project Implementation

34. Although the implementation of ongoing ADB-financed projects in Bhutan has improved, there are still a number of issues that impede project implementation. Common implementation issues are inadequate budget allocation and staffing (numbers and skills), frequent changes of project staff, weak procurement and contracting capabilities, insufficient delegation of authority, weak monitoring and coordination, and delays in consultant recruitment. During the country portfolio review mission (CPRM) and country program confirmation mission (CPCM) in November 1998, a time-bound action plan was agreed upon with the Government to address these issues. The country programming mission in April 1999 discussed with the Government the status of implementation of the action plan. Compliance has been good and several issues have been resolved. For example, adequate budgetary allocation for ADB-financed projects have been made. Counterpart staff, especially those trained under the projects, have been retained in their posts. ADB will continue to monitor outstanding issues through regular missions.

II. Country Operational Strategy

A. Current Strategy

35. The objective of the current country operational strategy (COS), which was prepared in July 1991, is to assist Bhutan's efforts to diversify the economy, with emphasis on strengthening the capacity of government agencies for economic management and development administration; improving physical and social infrastructure; promoting private sector development; and protecting the environment. To avoid unduly straining Bhutan's administrative and debt-servicing capacity, ADB has limited its loan assistance to relatively small magnitudes. It has primarily played a catalytic role in mobilizing additional resources and cofinancing, particularly on grant terms, using technical assistance for the preparation of development projects, and supporting necessary institutional development. ADB's strategy fully recognizes Bhutan's strong commitment to preserving its environment and all ADB assistance is compatible with this objective.

B. Implementation of the COS

36. Since its adoption, the 1991 COS has provided a good basis for ADB's operational program in Bhutan and for coordinating its work with other external funding agencies in the country. Considering the country's limited debt-servicing capacity, ADB has had to be highly selective in its interventions. The Government has also been careful in submitting projects for loan assistance to ADB, and has been constantly exerting efforts to use aid effectively. No major issue or difficulty has arisen in the implementation of the COS between the Government and ADB. ADB assistance has generally been successful in addressing the COS objectives (see paras. 30-33).

37. On private sector development, the Government is fully cognizant of the important role of the private sector in promoting employment and further development of the country. In accordance with the COS, ADB has been actively helping the Government address many of the constraints to private sector development. However, these efforts have been mostly on the supply side. Because of Bhutan's relatively small market, the scope and pace of private sector development are likely to be both limited and slow, unless the market is substantially expanded. This requires substantial progress in raising rural incomes and expanding exports both in terms of products and markets.

38. The COS will be reviewed and revised in 1999, taking into account the need to look at constraints on both supply and demand sides. The new COS will also have to reflect: (i) the changing macroeconomic environment, particularly issues involving public sector resources management and increasing pressure on the balance of payments; (ii) the changing role of foreign aid in financing public investment and the comparative advantage of ADB vis-à-vis other funding agencies; and (iii) development impact of ADB's assistance in the light of the evolving priorities of the Government.

III. Sector Strategies

A. Agriculture and Rural Development

39. Although the share of the agriculture sector in GDP has been declining, expansion of agricultural production is still important because of food security concerns and the need to increase rural incomes and improve the nutrition status of the population. The coverage of rural financial services has improved over the years. However, the rugged topography of Bhutan has constrained the expansion of agricultural production, and considerable efforts have been devoted to increasing the productivity of existing croplands. The constraints to productivity improvement and agricultural diversification are poor soil quality, fragmented farmland, limited technical know-how, and weak institutions and market infrastructure. Under the Eighth Plan, the Government will promote horticulture, cash crops, and livestock by providing infrastructure such as irrigation and small-scale dairy units, technical services, and training.

40. ADB has provided 19 TA grants amounting to \$7.7 million, including the Irrigation Action Plan in 1993 and the Irrigation Program Strengthening in 1997 and 2 loans totaling \$7.8 million for Chirang Hill Irrigation and Highland Livestock Development. The Government reiterated to ADB's Country Programming Mission in April 1999 that adequate grant assistance is available for agriculture sector development in the next few years, particularly from UNDP and the United Nations Capital Development Fund (UNCDF). As such, ADB is not planning any assistance in the agriculture sector for the next three years (see also para. 49).

B. Infrastructure

1. Energy

41. Bhutan is endowed with large hydropower resources. Expansion of power generation capacity has supported the growth of electricity-intensive industries in recent years. Similarly, revenue from power export has been able to finance the rapid expansion of social services especially education and health. The key development objectives in the energy sector are: (i) financial viability and sustainability of power operations through the corporatization of the Division of Power (DOP); (ii) revision of the tariff structure; (iii) private sector participation; and (iv) expanding power generation for exports.

42. ADB approved the first loan in the sector for the Rural Electrification project in 1995 together with a technical assistance for Institutional and Financial Development of DOP. This has provided an impetus for reforms in the sector and ADB will continue to focus on institutional development of DOP including its commercialization, and on the implementation of a tariff structure to reflect the economic cost of production. ADB's continued participation, including further processing of the proposed Sustainable Rural Electrification project in 1999, will require demonstrated commitment and progress to achieve the sector development objectives. The adjustment of domestic tariff is most crucial as an important step to (i) eliminate subsidy to industrial consumers and (ii) ensure financial viability of DOP. Failure to make the necessary tariff adjustment would delay the achievement of the overall sector development objectives and also ADB's further assistance to the sector.

43. Feasibility studies for large hydropower projects are being undertaken with assistance from funding agencies: Punatsangchu Hydropower Project of 765MW financed by the Japan International Cooperation Agency (JICA) and Mangdichu Hydropower Project of 360MW financed by the Government of Norway. These would require a large investment including cofinancing. ADB has included an ADTA in 2001 to help mobilize private sector participation in hydropower development. A Power Sector Review is also included in 2002 to assess the achievement and progress of power sector reforms and necessary improvements to further enhance efficiency in the power sector.

2. Transport

44. In the transport sector, the focus is on the maintenance of the road transport network. The Government's objectives in the sector are to develop a sustainable and regionally balanced transport system that is safe, convenient, and economical, to maintain past investment, and to develop road construction capabilities in the private sector. Other alternative modes of transport like ropeways and domestic airlinks, etc. were explored in previous studies financed by UNDP. The main issue revolves around the economic and financial viability of investments in these modes of transport. Lack of an efficient road network to markets has been constraining development of both agriculture and industry. The establishment of a road network that connects production bases and markets, especially to foreign markets, will enhance significantly the development of agriculture and industry. However, due to formidable natural constraints to road that make road construction extremely expensive when incorporating the costs of sustaining the delicate environment balance, limited institutional capacity, and relatively light vehicle traffic, the focus of the Government has been on maintenance of existing roads instead of construction of new roads.

45. The Government of India has played a major role in road construction and maintenance in Bhutan. ADB assistance in the road subsector will continue to focus on main roads and highways with close coordination with other funding agencies to ensure consistency and avoid overlapping of activities. ADB's policy dialogue has focused on: (i) institutional strengthening of the Division of Roads (DOR) to improve maintenance management; (ii) more efficient allocation of budgetary funds for road maintenance; (iii) development of the domestic contracting industry; and (iv) improvement in cost recovery. The recently completed ADB-financed East-West Highway Maintenance Project and two ADTAs addressed these issues. The project preparatory technical assistance (PPTA) for Road Transport Network Development is underway and a loan for Road Improvement is included in 2000. However, further processing of the project will depend not only on the viability of the new project, but also on the progress made on ADB's policy focus mentioned above.

46. The Government had earlier requested ADB assistance to improve rural access. ADB would like to build on past efforts in establishing necessary institutional capacity and focus future resources on main roads and highways. The World Bank and UNCDF are currently assisting in the feeder and rural road subsector in a complementary manner. ADB's ADTA in 2000 for Transport Sector Planning and Management will help in strengthening the road maintenance system, as well as in preparing a master plan for the transport sector, particularly main roads and highways with potential for subregional cooperation. The Government requested ADB to include under the study linkages to rural areas, where market opportunities can be enhanced. Based on the findings of the study, a loan for Transport Network Development is included for 2002 with PPTA in 2001.

3. Finance

47. Over recent years, substantial expansion of the financial sector and monetization of the economy have been achieved. Since 1980, the financial sector's contribution to GDP in real terms increased by an average of 12 percent per annum compared to GDP growth of 6.4 percent annually. Accompanying this rapid growth, several financial institutions have been established. Today, in addition to the Royal Monetary Authority (RMA) which fulfills the role of a central bank, there are four major financial institutions. In order to adequately regulate banking institutions in the country, the Government enacted the Financial Institutions Act in 1992 and RMA introduced its Prudential Guidelines in 1995. Despite these developments, there are still weaknesses and inefficiencies in the financial sector, which hinder efficient allocation of resources as well as savings mobilization.

48. ADB's strategy for supporting financial sector development involves several thrusts: (i) promoting private sector participation in the banking sector; (ii) deregulating interest rates through abolition of interest rate ceilings; (iii) strengthening the banking supervision function of RMA; and (iv) initiating the development of an incipient capital market to provide diversified sources of financing. ADB has provided the first policy-based lending to the country to establish the necessary policy environment in the financial sector to facilitate private sector development. The first tranche was released in 1998 and the second tranche is due in December 1999. Good progress has been made in complying with the second tranche release conditions.

49. ADB has provided other support to the financial sector of Bhutan, including the establishment of the second commercial bank, Bhutan National Bank (BNB), BDFC, and the Royal Stock Exchange of Bhutan (RSEB). ADB assistance is also underway to establish a pension fund and to strengthen the banking supervision function of RMA. Future assistance in the sector will build on the progress, achievement, and lessons learnt in ongoing and past assistance. Based on ADB's postevaluation findings and recommendations on past assistance to BDFC's industrial lending operations, necessary restructuring of BDFC to establish financial viability and sustainability in its overall operations will be supported under an ADTA included in 2000. UNCDF provided a credit line of \$1.5 million in association with an \$800,000 TA to BDFC to help it achieve financial sustainability in agricultural lending by 2002, mainly through decentralization of its agricultural operations. Institutional reform will be pursued through: (i) training financed by Netherlands Development Organization (SNV); and (ii) management advisory services provided by Rabo Bank Foundation. The International Fund for Agricultural Development's (IFAD) \$1 million agricultural credit line to BDFC will support agricultural development in eastern Bhutan. Close collaboration is needed in pursuing necessary restructuring of BDFC.

50. There is an urgent need to strengthen the capabilities of the four financial institutions⁹ in project appraisal, evaluation, and monitoring, including risk management. To support private sector development, an ADTA on Portfolio Management for Financial Institutions is planned for 2001 and may be considered as a standby project for 2000. A Financial Sector Review is planned for 2001 to assess the achievements and requirements to further develop the sector and support private sector development, particularly in the formulation of the long-term human resources and institutional development framework. Subject to the findings and

⁹ BDFC, BNB, Bank of Bhutan, and Royal Insurance Corporation of Bhutan.

recommendations of the review, ADTAs for Strengthening RSEB and Further Strengthening of RMA are tentatively included in 2002.

C. Social Infrastructure and Environment

1. Health

51. In the last 15 years the health status of the population of Bhutan has improved substantially (see also para. 18). Most of this improvement is the result of a significant increase in access to primary health care services, which was made possible by the establishment of 145 basic health units widely dispersed over the country. Immunization coverage among children is over 90 percent, a remarkable feat given the country's terrain and significant rural population. Similarly, the contraceptive prevalence rate has increased from 18 percent in 1994 to about 40 percent in 1998. Health indicators such as infant and maternal mortality have dropped, but remain high by regional standards. Despite the extraordinary accomplishments, the Bhutanese health care system faces some serious challenges. The 1994 National Health Survey found a population growth rate of about 3 percent per year and a total fertility rate of 5.6 children per couple.

52. The Government has requested ADB to assist in the health sector with a policy-based loan to improve health care systems. ADB indicated to the Government that the scope of ADB's involvement should be consistent with the sector development framework and should neither overburden the capacity of the Health Division nor overlap with activities of other funding agencies, particularly the Health Sector Programme Support II from Government of Denmark, as well as other health sector assistance from the Government of India, JICA, UNICEF, UNFPA, WHO, and the World Bank. A small-scale PPTA for Health Care Financing and Reform Program was approved and is being implemented this year. The TA focuses on three strategic areas including the financing, management, and regulation of the health system. Based on the findings and recommendations of the report, a policy-based loan is included for 2000. Further assistance to meet institutional requirements for improving health services efficiency is tentatively programmed for 2002.

2. Education

53. Enrollment at all levels has grown at an impressive rate over three and a half decades. For instance, the gross primary enrolment rate was estimated to have reached 72 percent in 1995 from a level of just 12 percent in 1980. Having achieved significant improvement in the country's basic education system, the emphasis in the sector is gradually shifting to skills development. The acute shortage of trained personnel at all skill levels, however, has been a major impediment to national development in Bhutan. To overcome this constraint, the country has had to rely on expatriate personnel. The Government has realized that dependence on expatriates is only a temporary solution. Developing indigenous human resources to improve the efficiency and productivity of public and private agencies is the long-range development objective. Bhutan's vocational training system, however, is inadequate, and there is a severe mismatch between the demand and supply of skilled workers in terms of quality and aspirations. The Government has introduced a policy to include vocational elements in the education system, in an effort to make education more relevant.

54. ADB has provided assistance for the establishment of the RIM and the Royal Bhutan Polytechnic (RBP), and a loan for Technical and Vocational Education and Training project. Based on the recommendation of ADB assistance, the National Technical Training Authority (NTTA) was recently established to strengthen the capabilities in providing necessary skills training to meet the market demand. Efforts under all existing technical institutes will be consolidated to achieve this objective under NTTA. It will be necessary to develop mechanisms to link closely training requirements with employment opportunities. An ADTA is planned for early 2000 to assess and develop the necessary institutional requirement of NTTA.

55. Based on the findings and recommendations of the PPTA for Basic Skills Development planned for 1999, a loan is programmed for 2001. Ongoing and related activities to support skills development, which were financed by Government of Denmark and UNDP through Ministry of Trade and Industry and Bhutan Chamber of Commerce and Industry as well as the World Bank and the Swiss Development Cooperation (SDC) under the Second Education Project, will need to be closely coordinated. The proposed loan from ADB will also be subject to the performance of the ongoing project on technical and vocational education and training. ADB had earlier discussed with the Government possible assistance for improving and expanding teachers' training. The Government indicated that this requirement is being met under SDC assistance and requested ADB to focus its resources on basic skills development.

3. Urban Development

56. Thimphu (the capital) and Phuentsholing (the commercial center) with some smaller district center towns are already experiencing rapid population growth (e.g., 7-10 percent growth per annum in Thimphu). Urban problems are conspicuous in large urban centers, including shortage of low-income housing, squatting on vacant government land, unplanned conversion of agricultural land without proper urban infrastructure, inadequate water supply, and sanitary/environmental problems due to inadequate solid waste, wastewater, and storm water disposal systems.

57. While urban planning was introduced during 1983-1987, it remains rudimentary due to shortage of experienced staff, an underdeveloped enforcement mechanism, and inadequate budgetary provision. The Government recently established the autonomous Thimphu City Corporation with the authority to impose and retain user charges for the provision of municipal services. This new institution needs to be fully developed with clearly defined responsibility and authority and with capabilities to undertake urban management effectively. Land management is underdeveloped, causing irregular development in the peripheral areas of large urban centers. The Government has recognized these issues and has adopted policies designed to develop regional growth centers, devolve authority to local levels, and provide needed urban infrastructure to the expanding urban population in Thimphu and Phuentsholing. Under the Eighth Plan, the Government plans to achieve a balanced and sustainable system of settlements, which would incorporate the growth center strategy. The Government has recognized the problem of rural-urban migration and has taken a comprehensive approach, namely: (a) population, family planning, and employment; (b) investment in rural areas to retain people in rural areas by creating job opportunities; (c) development of secondary towns; and (d) efficient management of the two major cities of Thimphu and Phuentsholing. ADB will assist the Government in achieving orderly urbanization on a sustainable basis through development of urban management systems and provision of project finance.

58. ADB's urban development focus is on urban infrastructure improvement. A loan was approved in 1998 to improve drainage, roads, footpaths, parking areas, and river protection works in Thimphu and Phuentsholing. Based on the urban sector consultation meeting held in April 1999, participants including government representatives and funding agencies agreed on the urgent need to assess the human resources requirement in the sector. This is most crucial to support and sustain the increasing activities and investments in the sector and to ensure that the absorptive capacity of the sector is not overstretched. Close coordination among active funding agencies including the Government of Denmark, ADB, UNDP, and the World Bank will be crucial. Under ADB's ongoing TA on capacity building in the urban sector, one of the major activities to be undertaken was the preparation of a draft housing sector policy document. This draft policy was completed in March 1999, and it provides an overall framework for further development by the Government of its final national housing policy statement. The policy document will guide the future development of the country's housing sector, including the subsequent preparation of housing programs, and will provide the focus for possible external support by funding agencies.

59. The draft housing sector policy provides the starting point for the development of a sustainable housing policy, but the finalization and eventual adoption of the policy must be one that is owned by the Government, one that they can fully endorse, and one that meets the aspirations of the community as a whole. The final housing sector policy and the possible future support by the Bank to the sector is premised on a number of fundamental issues being adequately addressed in the policy. The major requirement is that the housing policy must be shown to be financially sustainable. The issues that need to be carefully considered are: the development of affordable housing; full cost recovery, with limited subsidization only to the lower-income groups; identification of medium-term land requirements and development of a land bank for future housing needs, particularly in Thimphu and Phuentsholing; long-term housing finance mechanisms; and private sector participation in the provision of housing. ADB support to develop urban housing can only be provided after these issues have been adequately addressed, so that the long-term sustainability of the housing program is assured. The finalization and approval of the Government's housing sector policy is a requirement for ADB assistance to the sector. Assuming that these elements could be satisfied, a PPTA for Urban Housing Development is tentatively programmed for 2002.

4. Environment

60. Bhutan has a rich and largely intact natural resource base, but environmental problems are slowly emerging with soil erosion, land degradation and urbanization. Apart from NEC, the Government, recognizing the need to achieve sustainable development, also established the Bhutan Trust Fund (BTF)¹⁰ in 1991 to finance field activities for environment conservation. BTF has performed well financially and is conscientiously managed by a secretariat in Bhutan and offshore professional investors. Over the last two years, disbursements from BTF have increased.

61. Under ADB assistance,¹¹ the Government's EIA capabilities were strengthened. The Government was also able to establish the environmental guidelines for key sectors. While the

¹⁰ As of 1998, BTF has accumulated more than \$20 million from contributions of Global Environment Facility; Governments of Switzerland, the Netherlands, Denmark, Norway, and Finland; and the World Wildlife Fund.

¹¹ TA 2531-BHU: *Strengthening EIA Capabilities and Preparation of Environmental Guidelines*, for \$350,000, approved on 13 February 1996.

guidelines for six key sectors have been completed, the necessary environmental guidelines for the urban sector are still lacking. The Government will utilize its own resources to complete the environmental guidelines for the urban sector, which is considered a priority for the Government.

62. During the country programming mission in 1998, the Government requested a follow-up TA to operationalize and effectively implement the new EIA guidelines to ensure that economic development planning and decision making become environmentally sustainable. Accordingly, an ADTA for Strengthening EIA Implementation was included in the 2000 TA program. However, the Government informed the mission that this requirement is now being fully met by assistance from the World Bank, Government of Denmark, and UNDP. As such, the Government requested ADB to drop the proposed assistance to strengthen EIA implementation. Moreover, ADB's ongoing project on urban infrastructure development will help to improve the urban environment through upgrading of infrastructure facilities and strengthening capabilities in urban management (see also paras. 56-58).

D. Governance Dimensions of ADB Operations

63. Past and ongoing ADB assistance has contributed to improvements in capacities in public sector management, statistical operations, procurement, and contracting as well as promoting private construction companies. However, additional efforts are necessary to sustain improvement in development management, project management, and statistical operations. ADB will include further assistance to (i) promote effective public sector resources management through strengthening of capabilities in undertaking public expenditure analysis and foreign aid management in coordination with UNDP; (ii) enhance capacity for project implementation; and (iii) improve economic statistics, particularly on prices and national income accounts.

E. Gender Dimensions of ADB Operations

64. ADB's assistance in the past had not addressed gender issues directly because of the limited incidence of gender discrimination in the country. The laws of the country provide women with equal status and freedom as men. However, participation of women in economic activities has not yet been adequately addressed. ADB's future assistance to the country, particularly the proposed basic skills development project, will address gender issues with emphasis on skills development for girls. The COS for Bhutan will be revised in 1999 and, as background inputs to COS, a gender strategy is being prepared to assess gender issues in the country and to identify how ADB could further promote Bhutanese women's role in development through policy support and capacity building.

F. Private Sector Operations

65. In the Eighth Plan, the Government is committed to provide an "enabling environment" for private sector development in the country. The Government recognizes the important role of the private sector and considers it the single most important source of future employment. At the same time, tax revenues generated by an expanding private sector will become an additional source of revenue for the Government. The key constraints to private sector development are: lack of adequate physical infrastructure; stringent government policies over private sector activities; limited institutional and regulatory capabilities to effectively utilize

credit facilities; inadequate legal framework; limited entrepreneurial skills, including lack of manpower of varying levels of skills; and lack of information on export markets and modern technologies.

66. In addition, policy impediments have to be removed and support to enhance entrepreneurial skills is required. UNDP is assisting the Government in this effort, and ADB is closely coordinating with UNDP in formulating the proposed assistance in skills development. The Government will continue to pursue further liberalization of external trade, export promotion, and liberalize the access of foreign exchange for both industrial and consumption purposes.

67. ADB approved a sector development program (SDP) in 1997 to facilitate financial sector intermediation.¹² One component of the SDP is an equity investment in BNB. This is the first time that ADB had been involved in direct equity investment in Bhutan. Through this loan, ADB will assist the Government in implementing important financial reform measures, strengthening the capabilities of financial institutions, and developing entrepreneurship. Under ADB's proposed TA on portfolio management for financial institutions, project appraisal, monitoring and evaluation, and risk management will be enhanced to further support private sector development. ADB is preparing a private sector strategy this year to identify the most effective means of supporting private sector development in the country. ADB is also assisting the Government to corporatize the DOP with an agreed Action Plan for restructuring the power sector. ADB will also help to promote private sector participation in hydropower development.

IV. Regional Cooperation

68. The globalization of world economies has greatly intensified international competition and has, at the same time, given rise to a new wave of regionalism. Geographical proximity, economic complementarity, political commitment, policy coordination, and infrastructure development are factors conducive to formation of such groupings. Subregional economic cooperation, as one form of coordination, could offer the South Asian countries significant potential benefits. In 1997, Bangladesh, Bhutan, India, and Nepal agreed to establish the South Asian Growth Quadrangle (SAGQ), which will operate within the South Asia Association for Cooperation (SAARC) framework. Given their development potential, focus was to be given to five sectors: energy, multi-modal transport and communication, trade and investment facilitation and promotion, tourism, and natural resource utilization and environment. It was further agreed to proceed on a project-by-project building-block approach, covering bilateral as well as multilateral cooperation.

69. One possible area for subregional cooperation involving Bhutan is the further development of hydropower for export. Another potential area for subregional cooperation is the road subsector. The PPTA in 1998 for Roads Transport Network Development will involve improvement of the road networks in east and west Bhutan, as well as in the north-south corridor. Although this road project falls within Bhutan's national boundary, it has strong subregional linkages and benefits. The proposed improvement of the road networks will open

¹² Loan 1565-BHU(SF): *Financial Sector Intermediation Facility (Policy Loan)*, for \$4 million, approved on 23 October 1997; Loan 1566-BHU(SF): *Financial Sector Intermediation Facility (Development Finance Loan)*, for \$4 million, approved on 23 October 1997; Investment 7139-BHU: *Bhutan National Bank*, for \$800,000, approved on 23 October 1997; and TA 2902: *Capacity Building of Financial Sector Infrastructure and Entrepreneurial Development*, for \$500,000, approved on 23 October 1997.

up and enhance transit routes to India and Bangladesh, and provide Bhutan with access to seaports in these countries. It would also improve road connections to the Indian road system in West Bengal where a north-south corridor from the border to the port of Haldia is being developed. As a landlocked country, Bhutan's access to and from seaports in neighboring countries will be essential to break out of the limits imposed by a small domestic market.

V. Donor Activities and Aid Coordination

70. Bhutan has established a reputation as a developing country that is able to make full and effective use of the assistance available to it. External assistance mostly in the form of grants generally finance all the capital expenditures in the budget (see Appendix 3). Most of the external assistance to Bhutan are provided on a grant basis from bilateral and UN agencies. India is the largest bilateral source of aid. Others include Austria, Denmark, Japan, Netherlands, and Switzerland. Among the multilateral institutions, ADB is the largest funding agency, followed by UN agencies and the World Bank. There is close coordination among external assistance agencies in Bhutan, and UNDP plays a key role in the coordination. The last Round Table Meeting was held in January 1997. The Government indicated that the next meeting would be planned for late 2000 in Thimphu. In the meantime, the Government has actively pursued local coordination meetings of funding agencies by sector, which were found to be useful and effective in pursuing collaboration and cooperation among funding agencies.

VI. Cofinancing and Catalyzing External Resources

71. ADB plays a catalytic role in mobilizing additional resources through cofinancing/parallel financing for projects in Bhutan. In the past, there were two loans, namely, Second Multiproject and Urban Centers Sewerage Project, which the Government of Denmark cofinanced with grants of \$2.6 million and \$2.15 million equivalent, respectively. The Government of Denmark subsequently financed the entire Urban Centers Sewerage Project. Similarly, in the case of TA projects, ADB cofinanced a master plan for a forestry development project with the Government of Denmark, and an agriculture/horticulture project with UNDP. Subsequently, UNDP and UNCDF agreed to finance the investment project as well.

72. A possible cofinancing with UNDP/Global Environment Facility (GEF) was discussed earlier to support a mini/micro hydropower component for ADB's proposed Sustainable Rural Electrification this year. Unfortunately, this cannot be realized due to a delay in the processing of the project on the part of GEF. ADB in consultation with the Government will continue to explore actively cofinancing/parallel financing possibilities for the program period with GEF, UNDP, UNCDF, Government of Denmark, and other bilateral and multilateral agencies. A good candidate is the Basic Skills Development Project. Private financing would also be targeted for the two hydropower projects, for which feasibility studies are being conducted (see para. 43).

VII. ADB's Operational Program

73. The lending program for 2000-2002 will be maintained at an average annual level of about \$10 million per year, taking into account Bhutan's absorptive capacity. This reflects the country's per capita GNP and population size and is consistent with its absorptive capacity. The 1999 Country Programming Mission emphasized to the Government that due to limited ADF resources, the Government's contribution would need to finance more than 20 percent of total project cost as evidence of its commitment and ownership. The Government was also

informed that ADB's future lending to Bhutan will be linked to performance, particularly in macroeconomic and portfolio management. The lending and TA program for 1998-2002 is presented in Table 1 (see Appendix 4 for details). The Government and ADB agreed to limit its lending to a relatively narrow range.

Table 1: Lending and Technical Assistance Program, 1998-2002

| A. Public Sector Lending Program | | | | | | | | | | |
|----------------------------------|---------------|--------------|-------|--------------|-------|--------------|-------|--------------|-------|--------------|
| | 1998 (Actual) | | 1999 | | 2000 | | 2001 | | 2002 | |
| | (No.) | (\$ million) | (No.) | (\$ million) | (No.) | (\$ million) | (No.) | (\$ million) | (No.) | (\$ million) |
| Lending Program ^a | | | | | | | | | | |
| ADF | 1 | 5.7 | 1 | 10.0 | 2 | 12.5 | 1 | 7.0 | 1 | 10.0 |
| OCR | - | - | - | - | - | - | - | - | - | - |
| Lending Pipeline ^b | | | | | | | | | | |
| ADF | 1 | 5.0 | 1 | 10.0 | 2 | 12.5 | 1 | 7.0 | 1 | 10.0 |
| OCR | - | - | - | - | - | - | - | - | - | - |

| B. Technical Assistance Program | | | | | | | | | | |
|---------------------------------|---------------|----------|-------|----------|-------|----------|-------|----------|-------|----------|
| | 1998 (Actual) | | 1999 | | 2000 | | 2001 | | 2002 | |
| | (No.) | (\$'000) | (No.) | (\$'000) | (No.) | (\$'000) | (No.) | (\$'000) | (No.) | (\$'000) |
| TA Program ^a | 4 | 2,250 | 5 | 2,200 | 5 | 2,000 | 5 | 2,000 | 5 | 2,000 |
| TA Pipeline ^b | 5 | 2,350 | 5 | 2,200 | 5 | 2,000 | 5 | 2,000 | 5 | 2,000 |

^a The Program is comprised of the firm projects.

^b The Pipeline consists of the Program (firm projects) and standby projects. In 2001 and 2002, there is no distinction between firm and standby projects.

74. One loan per year is envisaged during the program period except for 2000, when two loans are proposed. TA grants total \$6 million for 15 TA projects, of which two are for PPTAs and 13 for ADTAs. In the 2000-2002 lending program, 50 percent of the projects will address economic growth with cross-cutting concerns, and 50 percent will address social concerns. There is no project solely addressing economic growth. The sectoral distribution and project mix over the program period is two projects each for transport and social infrastructure, respectively (Appendix 5).

VIII. Economic and Sector Work Program

75. The Country Economic Review for Bhutan was last prepared in June 1999 after the IMF Article IV consultation, in which ADB participated in January 1999, and will be updated in 2000. A new COS for Bhutan will be prepared in 1999 and finalized in early 2000. A social sector profile for Bhutan is being prepared to assess the performance and constraints to further improvement in social development in the country. ADB is also preparing a gender strategy for Bhutan to identify the role of effective ADB interventions in addressing gender issues. This will form the basis for preparing an action plan on gender and development as well as for identifying effective ADB interventions to enhance the role of women in development.

76. The economic and sector work (ESW) program for 2000-2002 will also provide policy and institutional framework for sector development in ADB's operational program. Country economic reviews/updates will be prepared annually for the next three years. In 2000, ADB will support effective public sector resources management through strengthening the capabilities in undertaking public expenditure analysis and foreign aid and external debt management (see paras. 33 and 63). ADB will also undertake sector work in transport sector planning and management including preparation of a master plan for the transport sector (see para. 46). A financial sector review is planned for 2001 to assess the achievements and requirements to further develop the sector and support private sector development. (see para. 50). A power

sector review is envisaged in 2002 to assess the achievements and progress of power sector reforms and necessary improvements to further enhance efficiency in the power sector (see para. 43).

IX. Local Cost Financing

77. Although the Government has been able to meet almost all the recurrent expenditures from its domestic resources since the 1990s, the scope for further expansion of domestic revenues remains very limited due to the largely rural and scattered population, and the small industrial and commercial base. Given the expansion of basic services particularly health and education in the past few years, the requirement to sustain these services will impose additional burdens on local resources. Continued efforts are being undertaken to improve tax administration and collection as well as to broaden the tax base through promotion of private sector activities. Preparation for the introduction of a personal income tax is a good example. The Government is also gradually introducing user charges and fees for basic services including water and sewage as well as education. Nevertheless, funding of a substantial portion of local currency cost by external sources of aid will still be necessary over the medium term. The local cost financing of ADB loans in Bhutan varies from less than 5 percent in the energy sector to more than 30 percent in the social infrastructure sector.

BHUTAN
COUNTRY PERFORMANCE INDICATORS

| Item | 1994 | 1995 | 1996 | 1997 | 1998 ^a |
|--|-------|-------|--------|--------|-------------------|
| ECONOMIC INDICATORS | | | | | |
| A. Income and Growth^b | | | | | |
| 1. GNP per Capita (dollars, current) | 420 | 430 | 450 | 480 | n.a. |
| 2. GDP Growth (% in constant prices) | 6.4 | 7.4 | 6.0 | 7.3 | 5.8 |
| Agriculture | 3.9 | 4.0 | 6.4 | 3.1 | 3.4 |
| Industry | 13.9 | 17.0 | 8.4 | 3.8 | 7.3 |
| Services | 5.2 | 7.0 | 5.1 | 13.4 | 8.2 |
| (percent of GDP) | | | | | |
| B. Savings and Investment (current market prices)^b | | | | | |
| 1. Gross Domestic Investment | 54.9 | 53.5 | 48.0 | 48.1 | 47.3 |
| 2. Gross National Saving | 42.3 | 40.8 | 30.9 | 35.8 | 36.5 |
| 3. Savings-Investment Gap | -12.6 | -12.8 | -17.2 | -12.3 | -10.9 |
| (annual percent change) | | | | | |
| C. Money and Inflation | | | | | |
| 1. Consumer Prices (annual average) | 5.9 | 8.2 | 9.3 | 7.4 | 9.0 |
| 2. Broad Money (M2) | 21.5 | 29.9 | 30.4 | 30.9 | 41.7 |
| (percent of GDP) | | | | | |
| D. Government Finance | | | | | |
| 1. Revenue (including grants) | 41.2 | 41.1 | 42.8 | 36.7 | 35.3 |
| a. Tax | 6.6 | 7.3 | 8.1 | 6.9 | 8.4 |
| b. Non-Tax | 14.0 | 12.9 | 11.5 | 11.8 | 11.9 |
| c. Grants | 19.2 | 20.0 | 22.5 | 17.6 | 14.5 |
| w/o India | 8.0 | 8.2 | 11.2 | 7.5 | 9.0 |
| 2. Total Expenditure and Net Lending | 41.8 | 41.0 | 40.6 | 39.1 | 32.0 |
| a. Current Expenditure | 20.5 | 21.5 | 18.8 | 18.5 | 17.4 |
| b. Capital Expenditure | 21.3 | 19.5 | 21.8 | 20.6 | 14.6 |
| 3. Current Surplus/Deficit (excl. grants) | 0.2 | -1.3 | 0.7 | 0.1 | 2.9 |
| 4. Overall Surplus/Deficit (-) | -0.6 | 0.1 | 2.3 | -2.4 | 3.3 |
| 5. Financing | 0.6 | -0.1 | -2.3 | -2.4 | 3.3 |
| a. External | 0.3 | -0.1 | -0.3 | 1.0 | n.a. |
| b. Domestic | 0.3 | 0.0 | -2.0 | 1.4 | n.a. |
| E. Balance of Payments | | | | | |
| 1. Merchandise Trade Balance (% of GDP) | -12.2 | -9.6 | -4.3 | -9.0 | -6.4 |
| with India (% of GDP) | -3.7 | -1.9 | 2.8 | 1.3 | 2.4 |
| 2. Current Account Balance (% of GDP) | -16.5 | -12.1 | -12.1 | -15.9 | -12.1 |
| with India (% of GDP) | -8.5 | -5.1 | -2.0 | -3.6 | -6.6 |
| 3. Export (\$) growth (annual percent change) | -4.1 | 10.2 | 39.6 | 1.7 | 12.0 |
| Exports to India (% of total exports) | 89.7 | 93.8 | 91.9 | 90.8 | 94.6 |
| 4. Import (\$) growth (annual percent change) | -25.7 | 4.6 | 14.1 | 18.4 | 3.7 |
| Imports from India (% of total imports) | 70.9 | 73.0 | 73.4 | 65.3 | 70.5 |
| F. External Payments Indicators | | | | | |
| 1. International Reserves (million dollars, end of period) | 106.9 | 121.0 | 145.1 | 176.0 | 215.5 |
| - months of imports | 13.8 | 14.9 | 15.7 | 16.1 | 19.0 |
| 2. External Debt Service (% of exports of goods & services) | 26.8 | 18.3 | 25.7 | 10.1 | 11.1 |
| 3. External Debt (% of GDP) | 58.0 | 48.4 | 39.1 | 33.8 | 34.8 |
| Memorandum Items: | | | | | |
| GDP (current prices, Million Nu) | 8,501 | 9,968 | 11,714 | 14,477 | 16,420 |
| GNP (current prices, Million Nu) | 7,867 | 8,760 | 10,467 | 13,336 | 15,370 |
| Exchange Rate (Nu per dollar, annual average) | 31.4 | 31.4 | 34.3 | 35.8 | 38.4 |
| Population (thousand) ^c | 566 | 583 | 600 | 618 | 637 |

GNP = gross national product; GDP = gross domestic product; n.a. = not available.

^a Provisional.

^b For calendar year, where FY1994 = Calendar Year 1994.

^c Calculated using the government population estimate of 600,000 in 1996 and the estimated growth rate of 3 percent per year.

Sources: *National Accounts Statistics Report*, September 1998, Central Statistical Organization.

Selected Economic Indicators, September 1998, Royal Monetary Authority of Bhutan.

BHUTAN
COUNTRY PERFORMANCE INDICATORS

| | 1985 | 1990 | Latest Year |
|--|--------------|--------------|-------------|
| POPULATION INDICATORS | | | |
| Total Population (thousands) | 547 (1993) | 564 (1994) | 618 (1997) |
| Annual Population Growth Rate (% change) ^a | 2.0 (1985) | n.a. | 3.10 |
| SOCIAL INDICATORS | | | |
| Total Fertility Rate (births per woman) | 5.9 (1984) | n.a. | 5.6 (1994) |
| Maternal Mortality Rate (per hundred thousand live births) | 770 (1984) | n.a. | 380 (1994) |
| Infant Mortality Rate (below 1 year; per '000 live births) | 142 (1984) | n.a. | 70.7 (1994) |
| Life Expectancy at Birth (years) | 47.5 (1984) | n.a. | 66.1 (1994) |
| Female | 45.8 (1985) | n.a. | 66.0 (1994) |
| Male | 49.1 (1985) | n.a. | 66.2 (1994) |
| Adult Literacy (%) | 23 (1980) | 38 (1990) | 54 (1996) |
| Female | | 25 (1990) | 28 (1996) |
| Primary School Enrolment (% of school age population) | 12 (1980) | 25 (1990) | 72 (1996) |
| Female | 7 (1980) | 19 (1990) | 60 (1996) |
| Secondary School Enrolment (% of school age population) | 17 (1980) | 31 (1990) | n.a. |
| Female | 2 (1980) | 5 (1990) | n.a. |
| Child Malnutrition (% of under age 5) | n.a. | 58.1 (1992) | 39.1 (1994) |
| Population Below Poverty Line (%) | n.a. | n.a. | n.a. |
| Income Ratio of Highest 20% to Lowest 20% | n.a. | n.a. | n.a. |
| Population with Access to Safe Water (%) ^b | 31 (1987) | n.a. | 58 (1996) |
| Population with Access to Sanitation (%) ^c | 50 (1985) | n.a. | 90 (1996) |
| Public Education Expenditure as % of GNP ^d | 3.6 (1986) | 3.1 (1990) | 5.3 (1995) |
| Public Health Expenditure as % of GDP ^d | 1.9 (1986) | 1.7 (1990) | 4.0 (1995) |
| Human Development Index ^e | 0.236 (1987) | 0.150 (1990) | .459 (1997) |
| Human Development Ranking ^e | 119 (1987) | 159 (1990) | 145 (1997) |
| ENVIRONMENTAL INDICATORS | | | |
| Land Use | | | |
| Per Capita Crop Land (ha.) | .10 (1983) | .09 (1990) | .08 (1993) |
| Cropland (% of land area) | n.a. | n.a. | 2.9 (1995) |
| Permanent Pasture (% of land area) | n.a. | n.a. | 5.8 (1995) |
| Extent of Forest and Woodland (% of total land area) | n.a. | 67.4 (1990) | 72.5 (1997) |
| National Protected Areas (%) (IUCN cat. I-V) | n.a. | 19.7 (1990) | 26.2 (1997) |
| Per Capita Commercial Energy Consumption (Giga joules) | 1 (1989) | 1 (1993) | n.a. |
| Per Capita Carbon Dioxide Emissions (metric tons) | .04 (1989) | .07 (1992) | .10 (1995) |

^a The figure for the latest year was obtained from Bhutan's 1994 National Health Survey.

^b Refers to population with access to safe drinking water.

^c Refers to population covered by health care.

^d GDP based on data from CSO; expenditure data are in fiscal year while GDP data are in calendar year.

^e The definition and derivation of HDI: *UNDP Human Development Report 1998*.

n.a. - not available

Sources:

Statistical Yearbook of Bhutan 1994.

Eighth Five-Year Plan, 1997-2002.

UNDP, *Human Development Report, 1999*.

ESCAP, *Statistical Yearbook for Asia and the Pacific, 1996*.

UNESCO, *World Education Report 1998*.

World Resources, *A Guide to the Global Environment 1998-99* and past issues.

Official Communication, *Central Statistical Organization (CSO)*, March 1999.

Key Indicators of Developing Asian and Pacific Countries, 1998.

BHUTAN
PORTFOLIO PERFORMANCE

Table 1 : Implementation, Disbursement Performance, and Postevaluation Results
Public Sector Projects only
(as of 31 December 1998)

| A. Project Portfolio ^b | Net Loan Amount \$ million % | | Rating (No.) ^a | | | | | | | | | | | |
|-----------------------------------|--------------------------------------|--------------|---------------------------|--------------|-------------------------|----------|----------|----------|------------------------|----------|----------|----------|----------|----------|
| | | | Total | | Implementation Progress | | | | Development Objectives | | | | | |
| | | | No. | % | HS | S | PS | U | HS | S | PS | U | | |
| Agriculture and Natural Resources | 0.0 | 0.0 | 0 | 0.0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Energy | 6.7 | 25.2 | 1 | 20.0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| Finance and Industry | 8.1 | 30.5 | 2 | 40.0 | 0 | 2 | 0 | 0 | 0 | 0 | 2 | 0 | 0 | 0 |
| Social Infrastructure | 11.8 | 44.3 | 2 | 40.0 | 0 | 2 | 0 | 0 | 0 | 0 | 2 | 0 | 0 | 0 |
| Transport and Communications | 0.0 | 0.0 | 0 | 0.0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Others/Multisector | 0.0 | 0.0 | 0 | 0.0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total | 27 | 100.0 | 5 | 100.0 | 0 | 5 | 0 | 0 | 0 | 0 | 5 | 0 | 0 | 0 |

| B. Disbursements ^c | OCR | ADF | Total |
|---|-----|------|-------|
| (1) Total funds available for withdrawal (\$ mn, active loans only) | 0.0 | 25.8 | 25.8 |
| (2) Disbursed amount (\$ mn, cumulative, active loans only) | 0.0 | 16.8 | 16.8 |
| (3) Percentage disbursed [(2)/(1)] (%) | 0.0 | 65.1 | 65.1 |
| (4) Disbursements (\$mn, active loans only, latest year) | 0.0 | 4.3 | 4.3 |
| (5) Disbursement ratio (%) ^d | 0.0 | 33.1 | 33.1 |

| C. Net Transfer of Resources (\$ million) | OCR | ADF | Total |
|---|-----|-----|-------|
| Net transfer in 1995 | 0.0 | 2.9 | 2.9 |
| Net transfer in 1996 | 0.0 | 2.1 | 2.1 |
| Net transfer in 1997 | 0.0 | 6.3 | 6.3 |
| Net transfer in 1998 | 0.0 | 3.4 | 3.4 |

| D. Post-Evaluated Projects | 1968 - 1977 | | 1978 - 1987 | | 1988 - 1998 | | 1968 - 1998 | | | |
|---|-------------|--------------|-------------|--------------|-------------|--------------|-------------|--------------|--------------|--------------|
| | No. | % | No. | % | No. | % | No. | % | | |
| 1. Postevaluation Rating (as of 31 December 1998) | | | | | | | | | | |
| Rated Generally Successful (GS) | 0 | 0.0 | 1 | 50.0 | 0 | 0.0 | 1 | 33.3 | | |
| Rated Partly Successful (PS) | 0 | 0.0 | 0 | 0.0 | 1 | 100.0 | 1 | 33.3 | | |
| Rated Unsuccessful (US) | 0 | 0.0 | 1 | 50.0 | 0 | 0.0 | 1 | 33.3 | | |
| No Rating (NR) | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | |
| Total | 0 | 0.0 | 2 | 100.0 | 1 | 100.0 | 3 | 100.0 | | |
| 2. Postevaluation Rating by Sector 1968-98 (as of 31 December 1998) | GS | | PS | | US | | NR | | Total | |
| | No. | % | No. | % | No. | % | No. | % | No. | % |
| Agriculture and Natural Resources | 1 | 100.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 1 | 33.3 |
| Energy | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Finance and Industry | 0 | 0.0 | 1 | 100.0 | 0 | 0.0 | 0 | 0.0 | 1 | 33.3 |
| Social Infrastructure | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Transport and Communications | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Others/Multisector | 0 | 0.0 | 0 | 0.0 | 1 | 100.0 | 0 | 0.0 | 1 | 33.3 |
| Total | 1 | 100.0 | 1 | 100.0 | 1 | 100.0 | 0 | 0.0 | 3 | 100.0 |

^a HS: Highly satisfactory; S: Satisfactory; PS: Partially satisfactory; U: Unsatisfactory

^b Excludes closed loans

^c Includes loans closed during the year with disbursements but excludes loans that are not yet effective.

^d Ratio of total disbursement in a given year over the net loan amount available at the beginning of the year plus the loan amounts of newly approved loans which have become effective. "Net loan amount at the beginning of the year" includes all effective loans at the beginning of the year. "Loan amounts of newly approved loans which have become effective" include loans approved before and after the beginning of the year that have become effective after the beginning of the year.

BHUTAN
PORTFOLIO PERFORMANCE

Table 2: Status of Project Implementation
Public Sector Projects Only
(As of 31 December 1998)

| Sector ^a | Project Title | Net Loan Amount | | Approval | Effectivity | Closing Date | | Physical | Cum. Contract | Cumulative | Project Performance Rating ^b | |
|---------------------|---|---------------------|---------------------|-----------------|-----------------|---------------------|--------------------|--------------------------|------------------------|------------------------------|---|--------------------------|
| | | OCR (\$ million) | ADF (\$ million) | Date (mm/yy) | Date (mm/yy) | Original (mm/yy) | Revised (mm/yy) | Progress (% complete) | Awards (\$ million) | Disbursement (\$ million) | Implementation Progress | Development Objective |
| ENE | Rural Electrification | 0.0 | 6.7 | Sep-95 | Feb-96 | Dec-98 | Dec-99 | 62 | 6.4 | 6.1 | S | S |
| F&I | Financial Sector Development Program | 0.0 | 4.0 | Oct-97 | Apr-98 | Jun-02 | - | - | 2.4 | 2.4 | S | S |
| F&I | Financial Sector Development Program | 0.0 | 4.1 | Oct-97 | Jul-98 | Jul-02 | - | - | 0.0 | 0.0 | S | S |
| SOC | Technical & Vocational Education & Training | 0.0 | 5.7 | Sep-90 | Nov-91 | Jun-98 | Jun-00 | 70 | 3.1 | 3.0 | S | S |
| SOC | Urban Infrastructure Improvement | 0.0 | 6.1 | Jul-98 | Mar-99 | Jun-04 | - | - | 0.0 | 0.0 | S | S |
| Total | | 0.0 | 26.6 | | | | | | 12.0 | 11.6 | | |

^a Sector:

ENE: Energy
F&I: Finance and Industry
SOC: Social Infrastructure

^b HS: Highly satisfactory; S: Satisfactory; PS: Partially satisfactory; U: Unsatisfactory

Note: Excludes cumulative disbursement of \$5.224 million for Loan No. 1265-BHU(SF): East-West Highway Maintenance, approved on 18 November 1993 and closed in 1998.

BHUTAN
OVERALL EXTERNAL ASSISTANCE
(\$ million)

| External Source | Past 3-5 Years (annual average) | | 1998 ^a | |
|---|------------------------------------|-------------|-------------------|-------------|
| | Loan/Credit | TA | Loan/Credit | TA |
| A. Multilateral Assistance | | | | |
| ADB | 4.2 | 1.6 | 4.2 | 1.1 |
| EC | | 2.7 | | 0.6 |
| IFAD | 1.0 | | 0.8 | |
| UNCDF | | 1.3 | | 1.3 |
| UNDP | | 3.0 | | 1.7 |
| UNICEF | | 2.4 | | 0.8 |
| WHO | | 2.5 | | 1.8 |
| WORLD BANK | 0.8 | 0.5 | 0.7 | 0.4 |
| Others | | 2.2 | | 1.2 |
| Subtotal | 6.0 | 16.2 | 5.7 | 9.0 |
| B. Bilateral Assistance | | | | |
| Austria | 2.0 | 2.7 | 5.0 | 2.0 |
| Denmark | | 8.3 | | 7.3 |
| India | 10.9 | 6.9 | | 29.0 |
| Japan | | 9.1 | | 1.3 |
| Kuwait | 1.2 | 0.2 | 0.1 | |
| Netherlands | | 3.1 | | 0.6 |
| Switzerland | | 5.6 | | 0.5 |
| Others | | 0.5 | | 0.1 |
| Subtotal | 14.1 | 36.4 | 5.1 | 40.9 |
| Total | 20.1 | 52.6 | 10.8 | 49.9 |
| Memo Items | | | | |
| External Assistance as % of Current Expenditure | 32.8 | 85.8 | 16.1 | 74.4 |
| External Assistance as % of Capital Expenditure | 32.8 | 85.7 | 21.4 | 98.9 |

^a on disbursement basis

ADB = Asian Development Bank; EC = European Community; IFAD = International Fund for Agricultural Development;
UNCDF = United Nations Capital Development Fund ; UNDP = United Nations Development Programme; UNICEF = United
Nations International Children's Emergency Fund; WHO = World Health Organization

Source: National Budget and Aid Coordination Division, Ministry of Finance.

BHUTAN
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2000-2002

| Sector/Project Name | Strategic Dev't Objectives* | | Responsible Division | Year of PPTA | PROJECT COST (\$ million) | | | | | |
|---|-----------------------------|-----------|----------------------|--------------|---------------------------|------|------|-------|-------|----------------------|
| | Primary | Secondary | | | TOTAL | Bank | | | Gov't | Cofinancing (Others) |
| | | | | | | OCR | ADF | Total | | |
| 2000 FIRM LOANS | | | | | | | | | | |
| Transport and Communications 1. Road Improvement | ECO | POV | IWTC | 1998 | 10.0 | 0.0 | 7.5 | 7.5 | 2.5 | tbd |
| Subtotal | | | | | 10.0 | 0.0 | 7.5 | 7.5 | 2.5 | tbd |
| Social Infrastructure 2. Health Care Reform Program | HD | POV | AWEH | 1999 | 5.0 | 0.0 | 5.0 | 5.0 | tbd | tbd |
| Subtotal | | | | | 5.0 | 0.0 | 5.0 | 5.0 | tbd | tbd |
| Total | | | | | 15.0 | 0.0 | 12.5 | 12.5 | 2.5 | tbd |
| 2001 LOAN PIPELINE | | | | | | | | | | |
| Social Infrastructure 1. Basic Skills Development | HD | POV | AWEH | 1999 | 7.0 | 0.0 | 7.0 | 7.0 | tbd | tbd |
| Total | | | | | 7.0 | 0.0 | 7.0 | 7.0 | tbd | tbd |
| 2002 LOAN PIPELINE | | | | | | | | | | |
| Transport and Communications 1. Transport Network Improvement | ECO | POV | IWTC | 2001 | 10.0 | 0.0 | 10.0 | 10.0 | tbd | tbd |
| Total | | | | | 10.0 | 0.0 | 10.0 | 10.0 | tbd | tbd |

^a ECO = Economic Growth; HD = Human Development; and POV = Poverty Reduction.

tbd = to be determined

BHUTAN
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2000-2002

| Sector/Project Name | Responsible Division | Type of TA | Amount (\$'000) | | |
|---|----------------------|------------|-----------------|------------|--------------|
| | | | Bank | Others | Total |
| 2000 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Finance and Industry | | | | | |
| 1. Restructuring of Bhutan Devt. Finance Corp. | IWFI | ADTA | 450.0 | 0.0 | 450.0 |
| Subtotal | | | <u>450.0</u> | <u>0.0</u> | <u>450.0</u> |
| Transport and Communications | | | | | |
| 2. Transport Sector Planning and Management | IWTC | ADTA | 800.0 | 0.0 | 800.0 |
| Subtotal | | | <u>800.0</u> | <u>0.0</u> | <u>800.0</u> |
| Social Infrastructure | | | | | |
| 3. Instl. Devt. of National Technical Training Authority | AWEH | ADTA | 300.0 | 0.0 | 300.0 |
| Subtotal | | | <u>300.0</u> | <u>0.0</u> | <u>300.0</u> |
| Others | | | | | |
| 4. Public Sector Resources Management | PW2 | ADTA | 300.0 | 0.0 | 300.0 |
| 5. Project Implementation Improvement | COPP | ADTA | 150.0 | 0.0 | 150.0 |
| Subtotal | | | <u>450.0</u> | <u>0.0</u> | <u>450.0</u> |
| Total | | | 2,000.0 | 0.0 | 2,000.0 |
| 2001 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Energy | | | | | |
| 1. Private Sector Participation in Hydropower Devt. | IWEN | ADTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Finance and Industry | | | | | |
| 2. Financial Sector Review | IWFI | ADTA | 400.0 | 0.0 | 400.0 |
| 3. Portfolio Management for Financial Institutions | IWFI | ADTA | 300.0 | 0.0 | 300.0 |
| Subtotal | | | <u>700.0</u> | <u>0.0</u> | <u>700.0</u> |
| Transport and Communications | | | | | |
| 4. Transport Network Improvement | IWTC | PPTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Others | | | | | |
| 5. Strengthening of Central Statistical Organization (Phase II) | EDSD | ADTA | 500.0 | 0.0 | 500.0 |
| Subtotal | | | <u>500.0</u> | <u>0.0</u> | <u>500.0</u> |
| Total | | | 2,000.0 | 0.0 | 2,000.0 |
| 2002 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Energy | | | | | |
| 1. Power Sector Review | IWEN | ADTA | 300.0 | 0.0 | 300.0 |
| Subtotal | | | <u>300.0</u> | <u>0.0</u> | <u>300.0</u> |
| Finance and Industry | | | | | |
| 2. Strengthening Royal Securities Exchange of Bhutan | IWFI | ADTA | 400.0 | 0.0 | 400.0 |
| 3. Strengthening of Royal Monetary Authority (Phase II) | IWFI | ADTA | 500.0 | 0.0 | 500.0 |
| Subtotal | | | <u>900.0</u> | <u>0.0</u> | <u>900.0</u> |
| Social Infrastructure | | | | | |
| 4. Urban Housing Development | AWWU | PPTA | 400.0 | 0.0 | 400.0 |
| 5. Health Services Efficiency Improvement | AWEH | ADTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>800.0</u> | <u>0.0</u> | <u>800.0</u> |
| Total | | | 2,000.0 | 0.0 | 2,000.0 |

BHUTAN
LENDING PROGRAM BY TYPE AND SECTOR, 2000-2002

| Classification | 2000 (Firm) | | 2001-2002 | |
|--|--------------------|----------|------------------|----------|
| | No. | % | No. | % |
| I. By Type | | | | |
| A. Economic Growth | - | - | - | - |
| B. Projects Directly Aimed at Social Concerns | 1 | 50 | 1 | 50 |
| C. Projects Directly Aimed at Environmental Concerns | - | - | - | - |
| D. Economic Growth-oriented Projects with Social and/or Environmental Concerns | 1 | 50 | 1 | 50 |
| Total | 2 | 100 | 2 | 100 |
| II. By Sector | | | | |
| A. Agriculture and Natural Resources | - | - | - | - |
| B. Energy | - | - | - | - |
| C. Finance and Industry | - | - | - | - |
| D. Transport and Communications | 1 | 50 | 1 | 50 |
| E. Social Infrastructure | 1 | 50 | 1 | 50 |
| Total | 2 | 100 | 2 | 100 |

BHUTAN

| PROJECT PROFILE | | | | | |
|--|------------|------------|---|--|--------------|
| 1. Project Name: Road Improvement Project | | | 2. Sector/Subsector: Transport & Communications/ Roads and Road Transport | | |
| 3. Dev. Objective: Primary: ECO Secondary: POV | | | | | |
| 4. Rationale: The objective of this project is to assist Bhutan in delivering a sustainable road transport network to provide access and economic development. | | | 5. Beneficiary Participation in Formulation: Consultation needs will be finalized with the assistance of PPTA consultants. | | |
| 6. Objectives and Scope: The scope of this project will include: (i) the implementation of a prioritized road development program, concentrated on three national highways, that will facilitate the social and economic development of Bhutan; (ii) the establishment of measures to increase the efficiency in the delivery of the sustainable road network, including the capability of the Public Works Division (PWD) to manage it; and (iii) the development of the capacity of the local construction industry and consulting profession. | | | | | |
| 7. Estimated Cost & Financing Plan (\$): Loan Project Cost (\$m): \$10.0 | | | Remarks The sharing of costs and the total cost to be estimated by the PPTA consultants in conjunction with the PWD. Possible cofinancing to be determined after discussion with other major funding agencies. | | |
| Financing (Source) | FC | LC | | | Total |
| Bank | 7.5 | 0.0 | | | 7.5 |
| Cofinancing | tbd | tbd | | | tbd |
| Borrower | 0.0 | 2.5 | | | 2.5 |
| Total | 7.5 | 2.5 | | | 10.0 |
| 8. Estimated Benefits and Beneficiary Groups: Since the three national highways that are the subject of this project are the only means of transport from east to west and north to south in Bhutan, the population at large will be the beneficiaries of the project. | | | | | |
| 9. Executing Agency: Public Works Division, Ministry of Communications | | | 10. Project Implementation Period: Start: 2000 End: 2004 | | |
| 11. Environment Category: B | | | 12. Processing Year: 1999-2000 | | |

BHUTAN

| PROJECT PROFILE | | | | |
|--|------------|------------|---|---|
| 1. Project Name: Health Care Reform Program | | | 2. Sector/Subsector: Social Infrastructure/Health and Population | |
| 3. Dev. Objective: Primary: HD Secondary: POV | | | | |
| 4. Rationale: Despite the extraordinary accomplishments of the last 15 years, the Bhutanese health care system faces some serious challenges. The 1994 National Health Survey found a population growth rate of about 3 percent per year and a total fertility rate of 5.6 children per couple. Acute respiratory tract infection and diarrhea, which are mostly preventable, remain widespread and account for 37 percent of all child deaths. There is also danger of increased smoking and the spread of HIV/AIDS. Effectively addressing these challenges will require adequate financial resources, improved quality of care, and effective public health regulations that are enforced. The program will introduce reforms in health care financing and public health regulation that will help make the health care system more effective and sustainable. | | | 5. Beneficiary Participation in Formulation: Beneficiaries will be interviewed as part of focus group discussions at the community level. They will also be asked about the quality of health services as part of a health facility survey. | |
| 6. Objectives and Scope: The program will address the most pressing strategic issues confronting the health care system in Bhutan, i.e., ensuring sustained financing, improving management capacity and quality of care, and regulating public health. It will introduce policy reforms to (i) increase resource mobilization, possibly including implementation of selective user charges and social insurance; (ii) employ cost-containment mechanisms; and (iii) introduce incentives into the system that encourage increased efficiency. The proceeds of the program will also be used to help establish a health trust fund. This will (i) help meet recurrent costs of effective health programs; (ii) ensure that vaccines and essential drugs are readily available; (iii) avoid future foreign exchange risks resulting from devaluation of the ngultrum; and (iv) encourage the introduction of new vaccine and drug technologies in a sustainable manner. | | | | |
| 7. Estimated Cost & Financing Plan (\$): Program Loan (\$m): \$5.0 | | | | Remarks Close coordination with major funding agencies in the sector will be undertaken during its formulation. |
| Financing (Source) | FC | LC | Total | |
| Bank | 5.0 | 0.0 | 5.0 | |
| Cofinancing | tbd | tbd | tbd | |
| Borrower | tbd | tbd | tbd | |
| Total | 5.0 | 0.0 | 5.0 | |
| 8. Estimated Benefits and Beneficiary Groups: The program will relieve the pressure on the current and capital expenditures of the annual national budget to further expand and improve the health care delivery systems in the country. The program will improve the quality of health services for people who currently have access to health care services. It will also allow further sustainable expansion of health services, which will benefit the people who are currently left out of the delivery systems as well as those who receive inadequate services. Primary health care services will be available to the entire population on a sustainable basis. | | | | |
| 9. Executing Agency: Health Division, Ministry of Health and Education | | | 10. Project Implementation Period: Start: 2000 End: 2002 | |
| 11. Environment Category: C | | | 12. Processing Year: 1999-2000 | |

ASIAN DEVELOPMENT BANK

**COUNTRY ASSISTANCE PLAN
(2000-2002)
PIPELINE UPDATE**

BHUTAN

June 2000

BHUTAN
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2000-2002

| Sector/Project Name | Strategic Dev't Objectives* | | Responsible Division | Year of PPTA | PROJECT COST (\$ million) | | | | | |
|---|-----------------------------|-----------|----------------------|--------------|---------------------------|------|------|-------|-------|----------------------|
| | Primary | Secondary | | | TOTAL | Bank | | | Gov't | Cofinancing (Others) |
| | | | | | | OCR | ADF | Total | | |
| 2000 FIRM LOANS | | | | | | | | | | |
| Transport and Communications 1. Road Improvement | ECO | POV | IWTC | 1998 | 9.6 | 0.0 | 9.6 | 9.6 | tbd | tbd |
| Subtotal | | | | | 9.6 | 0.0 | 9.6 | 9.6 | tbd | tbd |
| Social Infrastructure 2. Health Care Reform Program | HD | POV | AWEH | 1999 | 5.0 | 0.0 | 5.0 | 5.0 | tbd | tbd |
| Subtotal | | | | | 5.0 | 0.0 | 5.0 | 5.0 | tbd | tbd |
| Total | | | | | 14.6 | 0.0 | 14.6 | 14.6 | tbd | tbd |
| 2001 LOAN PIPELINE | | | | | | | | | | |
| Social Infrastructure 1. Basic Skills Development | HD | POV | AWEH | 1999 | 7.0 | 0.0 | 7.0 | 7.0 | tbd | tbd |
| Total | | | | | 7.0 | 0.0 | 7.0 | 7.0 | tbd | tbd |
| 2002 LOAN PIPELINE | | | | | | | | | | |
| Transport and Communications 1. Transport Network Improvement | ECO | POV | IWTC | 2001 | 10.0 | 0.0 | 10.0 | 10.0 | tbd | tbd |
| Total | | | | | 10.0 | 0.0 | 10.0 | 10.0 | tbd | tbd |

^a ECO = Economic Growth; HD = Human Development; and POV = Poverty Reduction.

tbd = to be determined

BHUTAN
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2000-2002

| Sector/Project Name | Responsible Division | Type of TA | Amount (\$'000) | | |
|--|----------------------|------------|-----------------|------------|----------------|
| | | | Bank | Others | Total |
| 2000 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Finance and Industry | | | | | |
| 1. Project Appraisal and Portfolio Management for Financial Institutions | IWFI | ADTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Transport and Communications | | | | | |
| 2. Transport Sector Planning and Mgt Strengthening Proj. | IWTC | ADTA | 954.0 | 0.0 | 954.0 |
| Subtotal | | | <u>954.0</u> | <u>0.0</u> | <u>954.0</u> |
| Social Infrastructure | | | | | |
| 3. Instl. Devt. of National Technical Training Authority | AWEH | ADTA | 300.0 | 0.0 | 300.0 |
| Subtotal | | | <u>300.0</u> | <u>0.0</u> | <u>300.0</u> |
| Others | | | | | |
| 4. Public Sector Resources Management | PW2 | ADTA | 300.0 | 0.0 | 300.0 |
| 5. Poverty Assessment and Analysis | PW2 | ADTA | 100.0 | 0.0 | 100.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Total | | | <u>2,054.0</u> | <u>0.0</u> | <u>2,054.0</u> |
| 2001 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Energy | | | | | |
| 1. Private Sector Participation in Hydropower Devt. | IWEN | ADTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Finance and Industry | | | | | |
| 2. Financial Sector Review | IWFI | ADTA | 400.0 | 0.0 | 400.0 |
| 3. Restructuring of Bhutan Devt. Finance Corp. | IWFI | ADTA | 450.0 | 0.0 | 450.0 |
| Subtotal | | | <u>850.0</u> | <u>0.0</u> | <u>850.0</u> |
| Transport and Communications | | | | | |
| 4. Transport Network Improvement | IWTC | PPTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>400.0</u> | <u>0.0</u> | <u>400.0</u> |
| Others | | | | | |
| 5. Strengthening of Central Statistical Organization (Phase II) | EDSD | ADTA | 500.0 | 0.0 | 500.0 |
| Subtotal | | | <u>500.0</u> | <u>0.0</u> | <u>500.0</u> |
| Total | | | <u>2,150.0</u> | <u>0.0</u> | <u>2,150.0</u> |
| 2002 TECHNICAL ASSISTANCE PROGRAM | | | | | |
| Energy | | | | | |
| 1. Power Sector Review | IWEN | ADTA | 300.0 | 0.0 | 300.0 |
| Subtotal | | | <u>300.0</u> | <u>0.0</u> | <u>300.0</u> |
| Finance and Industry | | | | | |
| 2. Strengthening Royal Securities Exchange of Bhutan | IWFI | ADTA | 400.0 | 0.0 | 400.0 |
| 3. Strengthening of Royal Monetary Authority (Phase II) | IWFI | ADTA | 500.0 | 0.0 | 500.0 |
| Subtotal | | | <u>900.0</u> | <u>0.0</u> | <u>900.0</u> |
| Social Infrastructure | | | | | |
| 4. Urban Housing Development | AWWU | PPTA | 400.0 | 0.0 | 400.0 |
| 5. Health Services Efficiency Improvement | AWEH | ADTA | 400.0 | 0.0 | 400.0 |
| Subtotal | | | <u>800.0</u> | <u>0.0</u> | <u>800.0</u> |
| Total | | | <u>2,000.0</u> | <u>0.0</u> | <u>2,000.0</u> |