

POVERTY REDUCTION PARTNERSHIP AGREEMENT
between
the Royal Government of Bhutan and the Asian Development Bank

I. INTRODUCTION

1. The concept of Bhutanese development philosophy is maximizing Gross National Happiness: that is to say, economic growth and material progress are not the only way to achieving personal fulfillment, but must be tempered by an equal emphasis on the advancement of an individual's spiritual and emotional security. Over time, therefore, economic development in a Bhutanese context has come to mean the balancing of economic progress *per se* with the maintenance of Bhutanese cultural and spiritual values, the improvement of social well-being, the preservation of the environment, and the promotion of good governance, all attained as a result of wide popular participation in decision-making. Resources have been used judiciously and fairly, therefore, and even though poverty remains, it is not associated with the abject wretchedness and human suffering so often found elsewhere. The caring and considerate nature of Bhutanese society means that even the most needy have been able to preserve their personal dignity and their self-respect.

2. This Poverty Reduction Partnership Agreement (the Agreement) flows from the discussions held at the Bhutan Poverty Forum (Thimphu, April 2001) and from the ADB's Country Operational Strategy (October 2000). It sets out a medium-term vision as well as agreed targets as the basis of the ADB's future program of assistance. The Agreement is also focussed on attainment of the International Development Goals (IDG) for 2015 as enunciated at the World Summit on Social Development in 1995. It incorporates agreed mechanisms to review performance and highlights milestones necessary to measure progress. It is envisaged that the future allocation of ADB resources will be linked to the achievement of progress under the Agreement but, in so doing, ADB will strive to be sensitive to the difficulties that the translation into Bhutan's national language of such words as "poverty", "vulnerable", etc. may have for many people. Therefore, poverty reduction in Bhutan will be perceived as being a way of *striving for improvement* rather than simply as a way of *addressing a problem*. Where vulnerability exists, and most accept that it does exist, such sensitivity for local feelings—and empathy for them—is designed to assist the Government in refining a consistent poverty focus for its own development program.

II. LONG-TERM GOALS (2002-2012)

3. The United Nations classifies Bhutan among the "least developed countries", ranking it 142nd out of 174 countries in its human development index for 1998 (published in 2000). Additionally, the GNP per head estimate of US\$560 in 1999, although higher than in several other countries at a similar stage of development, is still low: about US\$1.53 per head per day. Moreover, ADB staff estimates¹ indicated that a national average household expenditure per capita—as a reliable proxy for income—was Nu.1,261 (about \$27) per month (or about \$0.89 per day), including imputed values for own produced consumption and for rent and between 25 percent and 36 percent of the population live below the poverty line. Data limitations preclude any vigorous quantitative analysis as well as establishment of any meaningful target in terms of reduction in the percentage of the poor in Bhutan. However, a comprehensive household living standard survey is planned for 2004 to formally establish a poverty line for the country.

¹ Based on the *Household Income and Expenditure Survey* (2000) in Bhutan.

4. In terms of monetary incomes, therefore, poverty is widespread, particularly when one considers that 79 percent of the population lives in the rural areas where average household incomes are especially low. And aside from low incomes, poverty in Bhutan has a number of non-monetary dimensions. It manifests itself in low literacy levels, acute shortages in modern skills, poor nutrition and health indicators, gender disparities, inequitable access to the opportunities for better-paid employment and improved services afforded by development, inaccessibility to markets, and isolation. While there have been striking advances made over the past 20 years in all aspects of Bhutanese welfare, much remains to be accomplished, and many people have yet to experience the norms enjoyed by others. In practice, there are a number of geogs (blocks of villages) where vulnerability is particularly marked, especially among some of the more densely populated, remote, and inaccessible parts.

5. The Government's long-term vision and objectives are set out in its *Bhutan 2020 - A Vision for Peace, Prosperity and Happiness*, published by the Planning Commission in 1999. This strategic focus is on: (i) promoting human development; (ii) sustaining Bhutan's culture and heritage; (iii) achieving balanced and equitable development; (iv) improving governance; and (v) ensuring environmental sustainability. These elements underpin efforts to improve human welfare by promoting Gross National Happiness or, to reduce poverty of multi-dimensions in a comprehensive manner and constitute Bhutan's strategy for poverty reduction.

6. The Government and ADB agree that poverty reduction would be effectively addressed through sustained improvements in living standards and equity for all people in Bhutan. Key goals for 2012 include: reducing population growth rate to 1.3 percent, increasing life expectancy to 77 years, increasing monthly average rural incomes to about Nu.3,000 (about \$65) per head; raising adult literacy rate to around 100 percent; and decentralizing decision-making and planning at local levels. In addition, the Government will maintain no less than 60 percent forest cover at all times.

III. MEDIUM-TERM STRATEGY (2002-2008)

7. The Government and ADB will aim to reduce poverty through the income and employment generation impact of private sector-led development with a strategic theme of improving the quality of life for all in Bhutan. Emphasis will be put in the following areas: (i) enhance good governance; (ii) improve physical infrastructure and social development; (iii) promote private sector development; and (iv) protect the environment.

A. Good Governance

8. An important step in promoting governance nationally is the government initiatives in decentralizing decision making and planning to the district and block levels. The initiative should promote wider "ownership" of development projects, a greater personal identification with their selection and execution, and more popular, transparent participation in the process of government. Currently, the quality and number of staff at district and block levels to undertake these new functions are inadequate, physical facilities poor, and experience limited. ADB will support this nascent government initiative and play a key role by helping to mobilize grant support from other sources.

9. To improve governance in Bhutan, it is technical support that is required to improve development administration, not a change in attitudes and civic values among the administrators. ADB has provided considerable TA support for institutional strengthening in a number of government agencies: for improved policy analysis and macroeconomic

management, for procurement procedures and for contracting out certain functions to the private sector, and for statistical development. Accordingly, ADB will continue to build on past initiatives on a needs basis, but particularly for promoting (i) further strengthening of public sector resource management and aid coordination, by working in close contact with the other aid agencies in these fields; (ii) further enhancement of the sectoral capacity for project implementation; and (iii) further improvement in economic statistics, notably in prices, national income accounts, and selected demographic issues.

B. Physical Infrastructure

10. In view of the very large proportion of the population in rural areas and of the increasing issues associated with rural-urban migration, developing private sector activity in the rural areas of Bhutan represents an important opportunity for raising incomes nationally, for dispersing economic activity, and for addressing the income dimension of poverty reduction.

11. Improving physical infrastructure including road transport and rural electrification both within and running through rural Bhutan could provide (i) a potent force for market integration and the release of spontaneous private initiatives; (ii) improved access for tour groups, and a stimulus for the labor-intensive services and handicraft industries that cater to them; and (iii) in the case of power transmission and distribution, a means for developing local agroprocessing and generating alternative employment. In turn, this would help to promote balanced regional development, an important consideration of the Government. Emerging rural income and employment opportunities may also contribute to a slowing in the pace of rural out-migration.

12. **Road Transport.** ADB's assistance in the road transport will continue to focus on improvement of road network and maintenance. In particular, ADB support will concentrate on (i) institutional strengthening of the Department of Roads to improve road planning and maintenance management, (ii) development of the local contracting industry, (iii) more efficient allocation of budgetary funds for road maintenance, and (iv) improved cost recovery.

13. **Rural Electrification.** ADB will continue to support expansion of the domestic transmission and distribution system particularly to the rural areas targeting vulnerable households. In addition, the key objectives in the energy sector are (i) financial viability and sustainability of power operations through the corporatization of the Department of Power; (ii) revision of the tariff structure; (iii) private sector participation in the construction of power facilities and, potentially, in their ownership; and (iv) expansion in power generation for export.

C. Social Development

14. Consistent with the Government's view that personal fulfillment means more than material progress, ADB's view on poverty reduction has important non-income dimensions. Considering the access to the grants that most of the donor agencies provide in education and health sectors, ADB support will focus on the improvement in the cost recovery of public service delivery, as a means of promoting financial sustainability and national self-reliance. As a result, higher levels of government revenue can be generated to expand the delivery of basic social services and the targeting of vulnerable groups.

15. **Health.** While the Government has made excellent progress in health care, there is a need to put the long-term financing of health services on a sustainable footing, and to improve the quality of care as well as the efficiency with which it is dispensed. The establishment of the Health Trust Fund will help meet the recurrent costs of improved services, reduce the

fluctuations in the annual allocations of drugs and vaccines, and encourage the introduction of new vaccines and drugs on a sustainable basis. ADB's support in the health sector will focus on these aspects.

16. **Basic Skills.** The acute shortage of domestic skills is an abiding obstacle to the creation of productive job opportunities for the Bhutanese, to the development of the domestic private sector, and to accelerated economic growth. ADB support will pursue the country's need for skills so as to achieve a better balance in the supply of available skills and the demands of the labor market. This involves the creation of demand-driven structures for technical education and vocational education training by (i) strengthening the institutional capacity, (ii) addressing the negative perceptions of manual work, (iii) improving the quality of technical education and vocational training, and (iv) widening access to training facilities and programs. Widening access to training facilities and programs will be particularly important in the rural areas. Current programs cannot fully meet the needs of the rural population and they fail to attract many women even in urban areas.

17. **Urban Infrastructure.** The Government plans to achieve a more balanced, sustainable system of settlements, which will incorporate its growth center strategy. More broadly, it will seek to moderate the effects of rural-urban migration, on the one hand, through investment in rural areas so as to create rural employment opportunities areas and stem the flow of out-migrants; and, on the other, through development of secondary towns and supporting the urban infrastructure and management of Thimphu and Phuentsholing. ADB assistance will seek to support both prongs of the Government's policy: namely, support for accelerated rural private sector activity and employment, and support for urban improvement.

D. Private Sector Development

18. The Government acknowledges the private sector as the main engine of future income growth and employment generation, and several funding agencies, including ADB, are actively engaged in helping the Government to realize that objective. An ADB strategy for developing the private sector in Bhutan emerges from addressing the acknowledged constraints faced by the country's private sector. It will target the promotion of private sector investment by (i) supporting an improved policy setting and more efficient financial intermediation; (ii) improving road transport and expanding power transmission and distribution (see paras. 10-13); and (iii) strengthening vocational, technical, and basic skills (see para. 16). ADB will support the Government's efforts to provide an enabling environment for private sector development through (i) the continued rationalization and strengthening of banking and financial institutions; (ii) the continued liberalization of foreign trade, exchange, and investment regulations; (iii) the continued liberalization of interest rates so that they reflect the true underlying cost of resource mobilization, intermediation, and risk; and (iv) the continued preparation of transparent legislation and regulatory procedures.

E. Environment Protection

19. The Government's development policy places high priority on the need to protect and to maintain the environment. It has had a considerable degree of success in this regard. More than 72 percent of the country is still forested, and there are nine designated protected areas covering 26 percent of the total land area established to conserve biodiversity, protect species, and maintain ecosystems. ADB will support the Government in protecting the environment, through ensuring the environmental compatibility of ADB-sponsored projects. In addition, ADB will help to address the increasing stress being placed on housing and urban infrastructure by

rural-urban migration, thus improving the urban environment generally and providing added support for the low-income urban groups in particular.

IV. SHORT-TERM GOALS (2002-2004)

20. In the short-term, the Government and ADB will focus efforts in key sectors as outlined in the Country Strategy and Program Update 2002-2004 (August 2001). These include lending and TA interventions in (i) road transport; (ii) rural electrification; (iii) finance; (iv) urban infrastructure; (v) human development including health and basic skills; and (vi) governance. Key goals for the next three years include: (i) strengthen capabilities in road planning and maintenance; (ii) corporatization of Department of Power; (iii) maintain effective regulation of the financial system; (iv) improve management and provision of urban services in Thimphu and Phuentsholing; (v) enhance financial sustainability and quality of health care and basic skills development; and (vi) undertake necessary steps for a comprehensive living standard survey or another rapid assessment.

V. MONITORING AND EVALUATION ARRANGEMENTS

21. A major finding of recent research in Bhutan is the strong correlation between the overall poverty particularly income poverty and accessibility as evident in the geographical clustering of the more vulnerable households. Vulnerability is the result of varying combinations of the material and nonmaterial components of Bhutanese living standards. Reducing poverty in these circumstances thus seems to imply the need for a spatial focus in the development programs of the country. It is important for the Planning Commission and the Department of Aid and Debt Management to play a central role both in coordinating the timing and distribution of ministerial and donor initiatives, and in periodically assessing—say, at yearly intervals—the overall results achieved.

22. Over the next few years, and until statistical capabilities have been strengthened, monitoring the impact of poverty reduction programs may have to be mainly qualitative rather than quantitative. Once the statistical capabilities of the Planning Commission (mainly Central Statistical Organization) have been strengthened, it is envisaged that a comprehensive household survey of living standards will be undertaken and subsequently updated at regular intervals. Until that time, monitoring and evaluation based on the attached indicative targets will be undertaken by the Government with ADB assistance and discussed at the annual ADB Country Programming Missions to Bhutan.

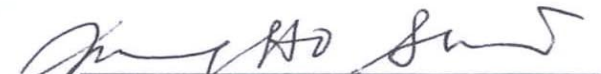
Signed in Thimphu, Bhutan on 23 October 2001.

On behalf of the Royal Government of Bhutan



Lyonpo Yeshey Zimba
Honorable Finance Minister

On behalf of the Asian Development Bank



Myoung-Ho Shin
Vice-President (West)

Attachment:

INDICATORS/ TARGETS—MONITORING AND EVALUATION FRAMEWORK

Priority Area	Indicators/ Targets	Timeframe	Monitoring Source
Income			
<ul style="list-style-type: none"> • Personal income tax 	<ul style="list-style-type: none"> • Undertake necessary actions and measures to introduce personal income tax in January 2002 	Immediate	MOF, DRC
<ul style="list-style-type: none"> • Average monthly rural incomes 	<ul style="list-style-type: none"> • Nu3,000 per head from around Nu1,000 per head 	1999-2012	PCS, CSO
Private Sector Development			
<ul style="list-style-type: none"> • Financial Sector 	<ul style="list-style-type: none"> • Maintain effective regulation of the financial system 	Immediate	RMA, MOF
<ul style="list-style-type: none"> • Legislative and regulatory environment 	<ul style="list-style-type: none"> • Maintain an effective legislative and regulatory framework 	Immediate	RMA, MOF, MOTI
<ul style="list-style-type: none"> • Share of manufacturing in GDP 	<ul style="list-style-type: none"> • 30% from about 10% 	1999-2012	CSO, MOTI
<ul style="list-style-type: none"> • Share of tourism in GDP 	<ul style="list-style-type: none"> • 25% from about 2% 	1999-2012	CSO, MOTI
Social Development			
<ul style="list-style-type: none"> • Population growth rate 	<ul style="list-style-type: none"> • 2.1% from 2.5% 	2000-2002	MOHE, DOH
	<ul style="list-style-type: none"> • 1.6% 	2007	
	<ul style="list-style-type: none"> • 1.3% 	2012	
<ul style="list-style-type: none"> • Primary school enrollment rate 	<ul style="list-style-type: none"> • 100% from 72% 	2000-2007	MOHE, DOE
<ul style="list-style-type: none"> • Maternal Mortality Rate 	<ul style="list-style-type: none"> • Less than 2 per 1,000 live births from 2.5 per 1,000 live births 	2000-2007	MOHE, DOH
<ul style="list-style-type: none"> • Rural coverage of safe sanitation 	<ul style="list-style-type: none"> • 90% from 88% 	1999-2007	MOHE, DOH
<ul style="list-style-type: none"> • Provision of potable water 	<ul style="list-style-type: none"> • 90% from 78% 	1999-2007	MOHE, DOH
<ul style="list-style-type: none"> • Adult literacy rate 	<ul style="list-style-type: none"> • 100% from 54% 	1999-2012	MOHE, DOE
<ul style="list-style-type: none"> • Average life expectancy 	<ul style="list-style-type: none"> • 77 years from 66 years 	1999-2012	MOHE, DOH
Physical Infrastructure			
<ul style="list-style-type: none"> • Post office for all villages and settlements 	<ul style="list-style-type: none"> • 100% from 65% 	1999-2002	MOC, Bhutan Post
<ul style="list-style-type: none"> • Percentage of rural population within a half-day's walk from the nearest road 	<ul style="list-style-type: none"> • 75% from 50% 	1999-2012	MOC, DOR, MOA
<ul style="list-style-type: none"> • Rural population with electricity 	<ul style="list-style-type: none"> • 50% from 22% 	1999-2012	MOTI, DOP
	<ul style="list-style-type: none"> • 75% 	2020	
Governance			
<ul style="list-style-type: none"> • Decentralization and local participation 	<ul style="list-style-type: none"> • Preparation of five-year plans at all local levels through community consultations from currently 50% 	2000-2007	MOHA, PCS
Environment			
<ul style="list-style-type: none"> • Forest cover 	<ul style="list-style-type: none"> • No less than 60% 	Immediate	NEC
<ul style="list-style-type: none"> • Environment Assessment Act, 2000 and its regulations 	<ul style="list-style-type: none"> • Enforce/ implement environment legislation and regulations 	Immediate	NEC
<ul style="list-style-type: none"> • Vehicle emission standards 	<ul style="list-style-type: none"> • Introduce and establish vehicle emission standards 	2002	NEC
<ul style="list-style-type: none"> • Water and air quality standards 	<ul style="list-style-type: none"> • Introduce baseline water and air quality standards 	2007	NEC
Monitoring and Evaluation Arrangements			
<ul style="list-style-type: none"> • Indicators/ targets for priority areas 	<ul style="list-style-type: none"> • Assess progress and achievement 	Annual	ADB, DADM, PCS
<ul style="list-style-type: none"> • Household Living Standard Survey 	<ul style="list-style-type: none"> • Undertake a comprehensive survey or another rapid assessment. 	2004	ADB, DADM, PCS

ADB-Asian Development Bank; CSO-Central Statistical Organization; DADM-Department of Aid and Debt Management; DBA-Department of Budget and Accounts; DOE-Department of Education; DOH-Department of Health; DOP-Department of Power; DRC-Department of Revenue and Customs; DUDH-Department of Urban Development and Housing; MOA-Ministry of Agriculture; MOC-Ministry of Communication; MOF-Ministry of Finance; MOHA-Ministry of Home Affairs; MOHE-Ministry of Health and Education; MOTI-Ministry of Trade and Industry; NEC-National Environment Commission; PCS-Planning Commission Secretariat; and RMA-Royal Monetary Authority