

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country:	Bhutan	Project Title:	Financial Market Development Program
Lending/Financing Modality:	Policy-Based	Department/ Division:	South Asia Regional Department/ Bhutan Resident Mission

I. POVERTY AND SOCIAL ANALYSIS AND STRATEGY

Poverty targeting: general intervention

A. Links to the National Poverty Reduction and Inclusive Growth Strategy and Country Partnership Strategy

The proposed program supports the Government of Bhutan's development objective under the Twelfth Five Year Plan, 2018–2023 of reducing multidimensional non-income poverty. The plan's key result areas supported by the program aim to create a strong macroeconomic environment (ensuring stable growth, a sustainable fiscal deficit, price stability, full employment, and a sound financial system).^a Given the importance of the finance sector in determining economic performance, Bhutan's commitment to develop and deepen the finance sector will help increase non-food consumption—historically the main driver of reducing poverty in Bhutan—helped by economic growth and better financial inclusion.^b The country partnership strategy for Bhutan, 2019–2023 of the Asian Development Bank recognizes the challenges to broad-based and inclusive economic development and the high levels of socioeconomic inequality.^c The private sector remains underdeveloped and dominated by micro, small, and medium-sized enterprises; its development is constrained by the nascent finance sector and limited access to finance. The proposed program is consistent with strategic pillar 1 of the country partnership strategy: dynamic economic reforms to foster a resilient and diversified economy. It will support inclusive economic growth with the following reform areas: (i) nonbank financial system developed, (ii) stability and integrity of the financial system strengthened, and (iii) financial inclusion promoted. This will have a strong impact on the achievability of the government's development objectives by improving the efficiency in mobilizing domestic resources.

B. Results from the Poverty and Social Analysis during Project Preparatory Technical Assistance or Due Diligence

1. **Key poverty and social issues.** Sustained socioeconomic development reduced Bhutan's national poverty rate from 12.0% in 2012 to 8.2% in 2017, with rural poverty declining from 16.7% to 11.9%, and urban poverty declining from 2.0% to 0.7% in the same period (footnote b). However, the country's limited financial market development has had disproportionate impact on the poor. Only 25.0% of adults in the poorest 40.0% of households in Bhutan reported having an account while in other developing economies the rate was 46.0% as of 2014. Also, as of December 2017, although 64.5% of adults in Bhutan had a savings account, only 6.0% had access to credit and 17.8% held a life insurance policy.^d Lack of access to affordable credit coupled with low financial literacy had constrained the ability of the poor to improve their lives.

2. **Beneficiaries.** The program is classified *general intervention*, as proposed outputs will benefit the entire population, including the poor. The program will contribute to sustained, broad-based, inclusive growth by speeding up growth in poorer regions and will indirectly reduce poverty among the more deprived groups, particularly by improving the non-income dimensions of well-being, such as living standards and access to basic public services and utilities. The third program reform area on financial inclusion will specifically benefit the poor by providing them with greater access to financial services. This will contribute indirectly to poverty reduction in rural and urban areas across the country. The program also includes the development of lending covenants for housing and home ownership, and the introduction of risk-sharing arrangements to help expand access to credit. With the deepening of the financial market, these initiatives will help meet the lending needs of underserved market segments backed by appropriate risk management tools and capacity, strict application of prudential regulatory requirements, and appropriate supervision and compliance monitoring.

3. **Impact channels.** A deepened nonbank financial sector, a sound financial system, and financial inclusion help reduce poverty and income inequality through at least two channels (section I.C). The rationale for the government's focus on finance sector development (including capital market development) is because of the proven link of its effect on economic growth and poverty. By enhancing the depth and stability of the financial market, the program is expected to improve financial inclusion and private sector investment, which will benefit underserved market segments. The program will have a broad impact on inclusive growth, and an indirect impact on poverty reduction.

4. **Other social and poverty issues.** No other issues were noted.

5. **Design features.** The program is designed to contribute to the government's efforts to continue its progress in strengthening the finance sector.

C. Poverty Impact Analysis for Policy-Based Lending

1. **Impact channels of the policy reforms.** The program's policy reforms on financial inclusion will increase access to and usage of financial services by the unbanked through the implementation of the action plan for the National Financial Inclusion Strategy, 2018–2023 and the National Financial Literacy Strategy, 2018–2023 (footnote d). Under the action plan, the establishment of a green finance scheme and the adoption of a warehouse receipt system will promote access to finance for the young entrepreneurs and farmers who do not have immovable assets like land or property to use as collateral.

2. **Impacts of policy reforms on vulnerable groups.** There are no adverse impacts. Positive impacts include enhancing access to financial services for the poorest 40.0% of the population. The implementation of financial literacy training seminars through the attached technical assistance will educate and promote financial access and usage of appropriate financial products and services by disadvantaged groups, including women and youth, enabling them to improve their lives.

3. **Systemic changes expected from policy reforms.** The program will have a positive effect on reducing poverty and attaining inclusive growth by enhancing access to finance for vulnerable groups and providing an enabling environment for capital market development.

II. PARTICIPATION AND EMPOWERING THE POOR

1. **Participatory approaches and project activities.** At the impact level, the program is aligned with Bhutan's Twelfth Five Year Plan, which was prepared through countrywide consultations and a bottom-up participatory approach by the government (footnote a). The program was prepared through (i) regular policy dialogues with the government, (ii) regular policy dialogues with the World Bank staff responsible for the Strengthening Fiscal Management and Private Sector Employment Opportunities Development Policy Credit Project, and (iii) participation as a full member of the International Monetary Fund Article IV review mission fielded in Bhutan in July 2018. Further, stakeholders including the Bhutan Chamber of Commerce and Industry, international and local civil society organizations, and development partners conduct wide-ranging consultations with financial institutions to gain a granular understanding of issues related to the deficiencies of the financial market.

2. **Civil society organizations.** Civil society organizations representing sectors affected by policy reform actions will be consulted as part of the government's reform implementation efforts, led by the Royal Monetary Authority.

3. The following forms of civil society organization participation are envisaged during project implementation, rated as high (H), medium (M), low (L), or not applicable (NA):

[L] Information gathering and sharing [L] Consultation [NA] Collaboration [NA] Partnership

4. Participation plan.

Yes. No. Participatory elements under specific reform activities will be carried out by the government, reflecting the policy-based nature of the support.

III. GENDER AND DEVELOPMENT

Gender mainstreaming category: some gender elements

A. Key issues. As of December 2017, of the 64.5% of adults in Bhutan who had a savings account with a bank, 56.0% were male and 44.0% were female. Only 16.1% had access to credit, of which 64.0% were male and 36.0% female. Similarly, of the 17.0% of adults who had insurance, 59.0% were male and 41.0% were female (footnote d). While most women in urban areas have fairly good access to financial products, the current financial products do not serve the unique needs of rural women whose gender roles inhibit them and who have to walk long distances to avail financial services. The limited number of financial access points also contributes to fewer women availing themselves of financial services. For instance, the number of microfinance—a preferred mode of service for rural women—branches per 10,000 adults was a meager 0.59 in 2017.^e These gender differences in access to credit and services tend to exacerbate other dimensions of poverty (through a disproportionate impact on women's productivity and earnings potential). The Global Financial Inclusion Database 2014 showed that account penetration for women in Bhutan was 28.0%, compared with an average of 50.0% in other developing countries. Although the proportion of women employed in agriculture decreased marginally beginning in 2006, in 2017 they still accounted for 83.4% of employed rural women, against 69.7% of employed rural men (footnote e). Loans to the agriculture sector accounted for only 5.3% (Nu5.07 billion) of loans in December 2017, despite being the sector that most women in Bhutan depend on economically. It supports the findings of a demand-side survey in 2013 that showed that use of informal financial services in rural areas was 94.0%, indicating that a higher proportion of this group was women.^f The National Financial Inclusion Strategy (footnote d) is likely to reduce this gender gap and benefit women. In Bhutan, in contrast with the rest of South Asia, inheritance rights and land and property rights have traditionally been vested in women.^g In addition, rural women are increasingly responsible for bringing farm produce to market and managing household finances. Men dedicate their time to labor while women take charge of financial management, including banking services, in addition to participating in farm labor. As a result, particularly in rural areas, women appeared to be well informed and knowledgeable about financial products. Additionally, women are more comfortable than men in managing banking technology such as ATMs and mobile phone banking. All these factors—women's landownership, their role in marketing the products of family businesses, and their expressed interest in banking technology—suggest a potential for women to be more integrated into the formal financial system.

