

RISK ASSESSMENT AND RISK MANAGEMENT PLAN

Risk Description	Rating	Mitigation Measures	Responsibility
Macroeconomic Stability			
<p>1. Economic growth. Lack of diversification impedes growth. Bhutan's economic growth is heavily concentrated on hydropower exports, to India.^a</p>	M	The government's economic reform measures are mobilizing domestic revenues through timely GST implementation, while prioritizing expenditure, planning for contingencies, and reducing reliance on hydropower.	MOF
<p>2. Fiscal position. Efforts to contain the COVID-19 pandemic have placed significant fiscal pressure on the government, widening fiscal deficit to 4.6% of GDP in FY2020-2021 and 8.7% in FY2021 – 2022-although Bhutan has maintained fiscal deficits within 3% of GDP since FY1993 and demonstrated a strong commitment to macroeconomic prudence prior to COVID-19. COVID-19 pandemic has necessitated immediate higher level of investment in the economy to propel sustainable level of growth. In addition, the delay in commissioning new hydropower projects coupled with the huge impact on tourism inflows have affected the performance of domestic revenue. The Government of Bhutan plans to offset the tax revenue lost through the GST approved in January 2020 and coming into effect from 1 July 2022. GST will also absorb the losses to a certain extent under excise duty which was previously received from India.^b This rebate accounted for more than 15% of total tax revenue in FY2018. The Government of Bhutan plans to offset the tax revenue loss through the GST approved in January 2020 and coming into effect from 1 July 2021. The GST will also absorb the losses to a certain extent under the excise duty that was previously received from India. The risk is that this may not be implemented because of the uncertain environment of the pandemic.</p>	M	<p>The government is undertaking expenditure rationalization measures to meet the cost recurrent expenditures from internal resources, including cutting down on travel, deferring benefits to civil servants, and providing current budget as annual grants. Fiscal deficits will be further serviced through external borrowings, and the issuance of government bonds and treasury bills.</p> <p>In addition to the above, the Government is also looking into broadening the existing tax base and other new areas of taxation that can be introduced.</p> <p>Bhutan has received extensive IMF support for implementing the GST. It has created a project office and prepared a GST implementation plan consisting of a detailed timeline, in line with IMF recommendations. This is supported by IMF TA.</p>	MOF
<p>3. Reduced tax revenue. Delays in two mega hydropower projects will further constrict tax revenue inflows. The first of the two projects was</p>	M	Aside from GST, some additional domestic revenue could be collected in the short term by updating the taxable asset values	MOF

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<p>commissioned in July 2019. The remaining one is expected to be commissioned in or after 2023, beyond the Twelfth Five Year Plan, 2018–2023 period.^o Risks in realizing the revenues from tax and other nontax sources are mainly because of the impact of the pandemic, which has affected business activities. This is further exacerbated by a loss in revenue of 11.1% in FY2020 and 14.0% in FY2021 on account of foregone revenue from tourism royalties, visa fees, and income taxes from businesses because of the pandemic.</p>		<p>used for assessing taxes on land and property that have been eroded by inflation. The property ownership transfer tax rate was reduced with the enhancement of the Property Ownership Transfer Tax Act of Bhutan, 2020. These measures will broaden the tax base with increased compliance and result in enhancement of revenue collections. The valuation of assets is carried out by different agencies. The government could also seek to rationalize and gradually curtail the use of tax exemptions (mainly indirect taxes), which were estimated to total 2.0% of GDP in FY2017. The government is in the process of reviewing and updating the Fiscal Incentives Act, 2017 in consonance with the COVID-19 situation. The new fiscal incentives are expected to be targeted, rationalized, and prudent. Loss in revenue is also offset by expenditure rationalization efforts.</p>	
<p>4. Reliance on India for investment. Weaker growth in India would adversely affect hydropower disbursements to Bhutan and non-hydropower exports as well as aid.</p>	M	<p>To help manage volatility, the government budgeted Nu100 million in FY2018 to kick-start a stabilization fund. In November 2017, the Parliament approved the establishment of the stabilization fund, which will enable the government to set aside some hydropower revenue for a more even distribution of expenditure. Currently, 5% of the royalty revenue from hydropower is deposited into the fund each year.</p>	MOF
<p>5. Higher inflation in India, which impacts inflation in Bhutan. Almost 52% of the total inflation in Bhutan is imported from India.</p>	M	<p>Measures in the areas of trade (e.g., implementing import substitution and boosting the domestic economy) could minimize the influence of imported inflation. Accommodative monetary and fiscal policy to (lower interest rates and moratoriums on loan repayments), support the development of real sector.</p>	MOF and RMA

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<p>6. Sizeable oil price increases.</p> <p>7. Financial system stability impacted by high NPLs arising mainly from the nonbank insurance sector, maturity mismatches, and thinning capital and low solvency.</p>	<p>M</p> <p>M</p>	<p>Reserve buffers can be used to adjust to oil price shocks.</p> <p>The RMA has introduced solvency requirements on all life insurance products. The main insurance business of insurance companies is life insurance. There was significant growth in the life insurance sector. However, insurance policy amounts constituted only 0.01% of GDP as of 2020. Although the solvency ratio was low at 25% versus the regulatory threshold of 100% in 2019, the ratio had improved to 68% in 2020 and the sector is expected to meet the 100% threshold in 2022. Banks will require higher capital to absorb losses from high credit growth and rising NPLs and better maturity alignment. RMA NPL resolution guidelines and gradual alignment with Basel III will help mitigate the risks.</p>	<p>MOF and RMA</p> <p>RMA</p>
Governance			
<p>8. Public financial management. Bhutan's overall public financial management risk is <i>moderate</i>. Key weaknesses have been identified in the areas of accounting and reporting, government, transparency, and budget reliability. The government is implementing a public financial management reform action plan to address these weaknesses.</p>	<p>M</p>	<p>ADB will continue strengthening financial management capacity of the government through</p> <ul style="list-style-type: none"> (i) training of selected government employees, especially at the local level, in project financial management and ADB procedures; (ii) building the capacity of the RAA to improve the timeliness and quality of project audit reports; and (iii) strengthening the effectiveness of internal audits. <p>The government also has implemented several measures that have improved public financial management in Bhutan. Key measures include the following:</p> <ul style="list-style-type: none"> (i) an online accounting system called the e-PEMS; (ii) an electronic payment system to enable near real-time settlements; 	<p>MOF and RMA</p>

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<p>9. Project management and implementation. Project executing agencies need greater capacity to perform multidisciplinary tasks. They should coordinate better with other agencies to fulfill statutory requirements and cope with external risks. They need to improve governance in terms of compliance and enforcement in project operations.</p> <p>10. Corruption. Bhutan has the lowest corruption perception in the South Asian region. It consistently scores high on global indexes for control of corruption. Bhutan was ranked 24th out of 180 countries in Transparency</p>	<p>M</p> <p>L</p>	<p>(iii) a web-based online human resource management system called ZEST; and</p> <p>(iv) the Government Payroll System, which is an interface of e-PEMS and ZEST.</p> <p>ADB is expanding operations in financial markets, but the concerned government agencies have limited capacity. Consequently, portfolio performance will be under further pressure. This risk will be mitigated by (i) sizing projects to align with individual agency capacities; (ii) mainstreaming capacity development in project design, management, and implementation; (iii) forging long-term partnerships by seeking clear and up-front commitments for strong leadership and the retention of key staff; and (iv) providing systematic support for on-the-job training with oversight of results.</p> <p>ADB has strengthened areas of vulnerability in accountability, internal control, and audit capacity in past programs.</p> <p>Bhutan has instituted a system of ethic-based governance to curb corruption. The two main integrity institutions are the RAA and ACC, which are widely respected for their independence and quality of work.</p>	<p>ADB and MOF</p> <p>ACC and RAA</p>

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International's 2020 Corruption Perceptions Index, although the domestic perception of corruption is reflects a more negative view.			
Organization			
11. Capacity. Weak implementation capacity of government agencies.	M	TA support is being provided under the program. ADB has a country resident mission to oversee program implementation.	MOF, RMA, Office of the Registrar, and MOWHS
12. Staff retention. Experienced staff are not retained in the relevant agencies during the entire program period, affecting the successful and timely completion of policy actions.	M	ADB will ensure consistent engagement and policy dialogue with the government to retain adequate staff with technical skills to ensure the sustainability of the reform program.	ADB, MOF, RMA, Office of the Registrar, and MOWHS
13. Coordination. Poor coordination among government agencies.	L	The MOF is the executing agency. The implementing agencies are the RMA and the MOWHS. A steering committee, chaired by the secretary of the MOF, will ensure better coordination among the agencies. The MOF is familiar with implementing ADB programs in the finance sector.	MOF, RMA, Office of the Registrar, and MOWHS
Overall	M		

ACC = Anti-Corruption Commission, ADB = Asian Development Bank, COVID-19 = coronavirus disease, e-PEMS = electronic Public Expenditure Management System, FY = fiscal year, GDP = gross domestic product, GST = goods and services tax, IMF = International Monetary Fund, L = low, M = moderate, MOF = Ministry of Finance, MOWHS = Ministry of Works and Human Settlement, NPL = nonperforming loan, RAA = Royal Audit Authority, RMA = Royal Monetary Authority, TA = technical assistance, ZES = Zhiyog Electronic System.

Note: The FY of the Government of Bhutan ends on 30 June. "FY" before a calendar year denotes the year in which the FY ends, e.g., FY2022 ends on 30 June 2022.

^a India was Bhutan's biggest development partner in the past 30 years, contributing to about 70% of total grant inflows.

^b Before India's introduction of the GST in July 2017, the Government of India collected and refunded annually to Bhutan the tax that India levied on the goods it exported to Bhutan. The remittance of the excise duty rebate has a time lag of 2 years. Since the introduction of a GST in India, the pre-GST taxes were subsumed under the GST regime, including excise duty. The arrangement stopped, as India introduced a GST during its FY2018 (ended March 2018). In FY2019, Bhutan could not collect any taxes as there was no mechanism to collect until a GST is implemented in Bhutan.

^c Government of Bhutan, Gross National Happiness Commission. 2019. [Twelfth Five Year Plan, 2018–2023](#). Thimphu.

Source: ADB.