



Country Partnership Strategy

August 2019

Bhutan, 2019–2023 —Fostering Diversification and Reducing Disparities

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 5 August 2019)

Currency unit	–	ngultrum (Nu)
Nu1.00	=	\$0.0143472023
\$1.00	=	Nu69.70000

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
COL	–	concessional ordinary capital resources lending
CPS	–	country partnership strategy
CSI	–	cottage and small industry
GDP	–	gross domestic product
ICT	–	information and communication technology
IED	–	Independent Evaluation Department
KPS	–	knowledge product and service
MOF	–	Ministry of Finance
NKRA	–	national key result area
SASEC	–	South Asia Subregional Economic Cooperation
SDF	–	South Asian Association for Regional Cooperation Development Fund
SDG	–	Sustainable Development Goal
TA	–	technical assistance
TVET	–	technical and vocational education training

NOTES

- (i) The fiscal year (FY) of the Government of Bhutan ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 30 June 2019.
- (ii) In this report, “\$” refers to United States dollars.

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COUNTRY AT A GLANCE

Economic^a	FY2014	FY2015	FY2016	FY2017	FY2018
GDP (\$ billion, current)	1.83	2.03	2.12	2.36	2.64
GDP per capita (\$, current)	2,455.2	2,678.9	2,759.3	3,210.8	3,555.1
GNI per capita (\$, atlas method)	2,340.0	2,400.0	2,520.0	2,660.0	...
GDP growth (% , in constant prices)	4.0	6.2	7.4	6.3	5.5
Agriculture	2.4	3.7	4.4	3.6	4.5
Industry	3.8	6.0	7.6	4.6	2.6
Services	5.0	8.4	9.2	8.2	8.0
Gross domestic investment (% of GDP)	49.0	52.9	54.7	53.2	...
Gross domestic saving (% of GDP)	27.6	27.1	28.5	31.6	...
Consumer price index (annual % change)	9.6	6.7	3.3	4.3	3.6
Liquidity (M2) (annual % change)	6.6	7.8	15.8	31.5	10.4
Overall fiscal surplus (deficit) (% of GDP)	3.8	1.5	(1.1)	(3.4)	(0.7)
Merchandise trade balance (% of GDP)	(21.5)	(21.2)	(26.6)	(19.8)	(15.7)
Current account balance (% of GDP)	(26.4)	(28.3)	(31.1)	(23.2)	(18.2)
External debt service (% of exports of goods and services)	27.1	19.8	14.5	24.9	23.4
External debt (% of GDP)	94.0	94.0	111.3	103.0	105.4

Poverty and Social	2000	Latest Year
Population (million)	0.60	[2000] 0.73 [2017]
Population growth (annual % change)	1.30	[2000] 1.30 [2017]
Maternal mortality ratio (per 100,000 live births)	423.00	[2000] 121.00 [2017]
Infant mortality rate (below 1 year/per 1,000 live births)	59.40	[2000] 25.60 [2017]
Life expectancy at birth (years)	60.29	[2000] 70.20 [2016]
Adult literacy (%)	52.81	[2005] 66.60 [2017]
Primary school gross enrollment (%)	72.00	[2000] 105.60 [2018]
Child malnutrition (% below 5 years old)	14.10	[1999] 12.80 [2010]
Population below poverty line (%)	31.70	[2003] 8.20 [2017]
Population with access to safe water (%)	86.10	[2000] 98.00 [2017]
Population with access to sanitation (%)	38.70	[2000] 74.8 [2017]

Environment	Year
Carbon dioxide emissions (thousand metric tons)	1,001.09 [2014]
Carbon dioxide emissions per capita (tons)	1.29 [2014]
Forest area (million hectares)	2.73 [2016]
Urban population (% of total population)	37.80 [2017]

ADB Portfolio (active loans and ADF grants)^b	As of 31 December 2018
Total number of loans and ADF grants	
Sovereign	18
Nonsovereign	1
Total loan and ADF grant amount (\$ million) ^c	
Sovereign	314.48
Nonsovereign	0.25
Disbursements (sovereign)	
Disbursed amount, total (\$ million, 2018)	34.4
Disbursed amount, excluding PBL (\$ million, 2018)	34.4
Disbursement ratio, excluding PBL (%)	18.4

... = not available, () = negative, [] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, GNI = gross national income, M2 = broad money, OCR = ordinary capital resources, PBL = policy-based lending.

^a Fiscal year ending 30 June, e.g., FY2018 ends on 30 June 2018.

^b Covers ADF and OCR financing for projects and programs, including policy-based lending unless otherwise stated.

^c Net of droppages and cancellations.

Sources: ADB staff estimates; Government of Bhutan, Royal Monetary Authority of Bhutan. 2019. *Annual Report 2018*. Thimphu; World Bank. World Development Indicators database (accessed 1 March 2019); and Government of Bhutan, National Statistics Bureau. [Statistical Yearbook of Bhutan 2018](#). Thimphu.

I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT

1. **Key development challenges.** During the Eleventh Five-Year Plan period (2013–2018), Bhutan experienced rapid economic growth averaging 5.9% per annum.¹ Gross domestic product (GDP) per capita increased from \$2,522.1 in fiscal year (FY) 2013 to \$3,555.1 in FY2018. Bhutan is on course to graduate from the list of least-developed countries of the United Nations (UN) in 2023.² The sustained level of economic growth has translated into significant progress in human development, poverty reduction, and living standards. Nonetheless, Bhutan remains vulnerable to economic volatility because of the country's small size, narrow economic base, limited connectivity, and susceptibility to climate change and natural disasters.

2. During the Twelfth Five-Year Plan (12th plan) period (2018–2023), Bhutan will face ongoing and emerging challenges caused by structural imbalances, income disparities, and climate change.³ The country's economy relies heavily on hydropower exports. External trade is skewed towards one partner—India—which accounts for about 80% of external trade. The agriculture sector, which employs two-thirds of the labor force, is dominated by relatively nonremunerative small-scale subsistence farming. Rural–urban migration overburdens urban centers, which were not designed for the massive influx of population. Youth unemployment rose to 15.7% in 2018, while the overall unemployment rate in 2018 was only 3.4%. The private sector, whose scope is still limited, is developing only sluggishly and does not create enough jobs to absorb the unemployed youth.⁴ Promoting private sector development, strengthening market and institutional capacities, and improving infrastructure and connectivity will be major challenges during the 12th plan.

3. **ADB strategic objectives and priorities.** The strategic objectives of the country partnership strategy (CPS), 2019–2023 of the Asian Development Bank (ADB) are to foster economic diversification and reduce spatial and social disparities. The CPS will focus on three strategic priorities: (i) dynamic economic reforms to foster a resilient and diversified economy, (ii) improved connectivity to provide access to information and markets, and (iii) greater inclusiveness through more equitable socioeconomic development. Paras. 30–43 elaborate the areas of assistance related to these priorities.

4. **Alignment with government development priorities and ADB's strategic agendas.** The CPS is aligned with Bhutan's Nationally Determined Contribution, the 12th plan, and ADB's Strategy 2030 and its operational priorities.⁵ The strategic objectives of the CPS enable a focused and differentiated approach to a country that is small and landlocked. The approach is consistent with the key thrust of ADB's Strategy 2030, aiming to create quality jobs by fostering small and medium-sized enterprises and inclusive businesses.

5. **ADB value addition.** ADB will add value to Bhutan's development by combining finance, knowledge, and partnership in its ongoing and future operations. As a long-term development partner with the largest investment portfolio after the Government of India, ADB is well-positioned

¹ ADB. 2019. [Asian Development Outlook: Strengthening Disaster Resilience](#). Manila.

² Based on the level of GDP per capita alone, Bhutan is classified as a lower middle-income country. However, based on UN criteria, Bhutan has been classified as a least-developed country because it has been highly vulnerable to economic and environmental shocks and had low levels of human assets.

³ Government of Bhutan, Gross National Happiness Commission. 2018. [Twelfth Five-Year Plan \(2018–2023\)](#). Thimphu.

⁴ Government of Bhutan, Ministry of Labour and Human Resources. 2018. [Labour Force Survey Report 2018](#). Thimphu.

⁵ Government of Bhutan, National Environment Commission. 2015. [Intended Nationally Determined Contribution](#). Thimphu; ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

to support crucial reforms and investments as envisaged in the 12th plan. ADB will promote knowledge sharing, best practices, and innovation. ADB is committed to support private sector operations by attracting private investments and commercial cofinanciers.

II. COUNTRY DEVELOPMENT CONTEXT

6. **Strong development performance.** Bhutan's economy has witnessed rapid growth over the past three decades from FY1988 to FY2018, recording an average annual growth of 7.0%. Significant gains in poverty reduction have been achieved over the past decade with national poverty rate declining from 23.0% in 2007 to 8.2% in 2017. Multidimensional poverty has reduced to 5.8% in 2017 from 12.7% in 2012, which is reflected in the improved access to basic infrastructure and social services. Extreme poverty has almost been eliminated, with only 1.5% of the population living on less than \$1.90 purchasing power parity per day in 2017.⁶ Bhutan has made significant progress in all key areas of human development, as reflected in increased life expectancy, high immunization coverage, reduced out-of-pocket expenditures on health, years of schooling, and enrollment in primary and secondary education. The country has also achieved almost all Millennium Development Goals, notably the goals of eradicating extreme hunger and poverty, reducing child mortality, and ensuring environmental sustainability. Bhutan is close to achieving universal primary education.

7. **Challenges to maintaining development momentum.** Bhutan is entering a new development phase, during which the country will have to consolidate past gains and remove constraints on sustainable development. In the medium term, economic growth is likely to slow because of expected delays in implementing hydropower projects and sluggish private sector development. Bhutan needs to embark on a course of critical reforms to diversify the economy by enabling the private sector to expand and drive growth. The inclusive and sustainable growth assessment identified two key challenges that Bhutan must overcome in the medium term: vulnerabilities caused by structural imbalances, and spatial and social disparities.⁷

A. Structure-Induced Vulnerabilities

8. **Dominance of hydropower.** Public-sector-led hydropower development has driven Bhutan's outstanding economic performance.⁸ Hydropower contributes about 25% to total GDP annually, accounts for 32% of total exports, and generates about 25% of the government's total domestic revenue. Hydropower-centered growth has, however, caused imbalances and disparities in several areas. The massive scale of hydropower projects relative to the small size of the economy has created large fluctuations of aggregate demand, both during the construction phase and after projects become operational. The capital-intensive nature of the hydropower industry has not contributed adequately to the creation of employment opportunities for the growing youth population entering the labor market.⁹ The high import content of hydropower construction creates a large external imbalance and high external debt, which has at times

⁶ Royal Government of Bhutan, National Statistics Bureau. 2017. *Bhutan Poverty Analysis Report 2017*. Thimphu

⁷ Inclusive and Sustainable Growth Assessment (accessible from the list of linked documents in Appendix 3).

⁸ The government is developing hydropower using four modalities: (i) intergovernment investment with the Government of India, (ii) intergovernment joint venture between Druk Green Power Corporation and central public sector undertakings of the Government of India, (iii) public-private partnership, and (iv) development solely by Druk Green Power Corporation.

⁹ The government introduced other renewable energy sources—including wind, solar, and biogas—to improve energy access for poor people, many of whom live in remote, off-grid areas. Independent Evaluation Department. 2018. *Validation Report: Green Power Development Project in Bhutan*. Manila: ADB.

exceeded 100% of GDP.¹⁰ Hydropower-related contributions to the budget have generated public sector growth and procyclical fiscal policies. The tax–GDP ratio has stagnated, both because tax exemptions have proliferated and the nonhydropower private sector remains nascent. Delays in commissioning ongoing hydropower projects will further increase fiscal pressures.

9. **Public–private sector discord.** The public sector plays a dominant role in Bhutan’s economy, which is reflected in the large number of state-owned enterprises supervised by the Ministry of Finance (MOF) and government-linked companies managed by Druk Holding and Investments. Public investments in commercially oriented, government-linked companies have been instrumental in developing the energy, finance, manufacturing, and agribusiness sectors. In contrast, the private sector has mainly made only small-scale investments. The small size of the country and its domestic market, limited access to finance, inadequate physical and information and communication technology (ICT) connectivity, limited access to foreign markets, and a shortage of skilled workers have stifled private sector development. The government has launched reforms and provided incentives to improve the regulatory environment for private business operations. Among the reform measures are a new licensing policy, simplified property registration, revised foreign direct investment rules and regulations, and priority sector lending to support cottage and small industries.

10. **Imbalanced finance sector development.** Bhutan’s finance sector has been growing and diversifying rapidly. The private sector credit–GDP ratio increased from 15.4% in 2005 to 50.6% in 2018.¹¹ However, rising private credits do not benefit the populace evenly. Small and medium-sized enterprises have limited access to finance, whereas demand for credit is generally underserved in rural areas. Banking services need to be better aligned with the needs of rural clients, who require less complex and nonconventional services, accessible deposit and withdrawal procedures, flexible loan conditions, and small periodic savings and loan services. In urban areas, high land prices and mortgages at market interest rates translate into poor repayment terms. Home ownership thus remains an unattainable goal for low-income people. The inability to purchase one’s own home means heavy dependence on rental housing accommodation, limiting urban families’ ability to save and build equity, which in most other countries is a major personal asset.

11. As the economy expands, the financial market will have to be broadened and deepened. The government borrows directly from state-controlled banks and meets its domestic financing needs predominantly through the narrow treasury bill market, which is subject to a high rollover risk. With the expected decline in concessional financing, the government will need reliable and efficient sources of domestic financing that can be provided by a deep and well-functioning public debt market, combined with innovative financing methods. This will be essential to fund long-term investment in infrastructure and other strategic financing objects. It will also provide opportunities for institutions like pension funds to invest in long-term funds.

¹⁰ The bulk of Bhutan’s debt is for hydropower projects from the Government of India. It is about 74% of GDP, denominated in Indian rupees, and is close in nature to foreign direct investment. The International Monetary Fund debt distress classification for Bhutan is *moderate*. International Monetary Fund. 2018. [Bhutan: 2018 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Bhutan](#). Washington, DC.

¹¹ Bhutan’s finance sector consists primarily of the banking subsector (three public and two privately controlled commercial banks, and two foreign direct investment banks) and the nonbank finance subsector (comprising a pension fund, two insurance companies, and a nonlife reinsurance company), along with a small capital market.

12. **Concentration of external trade on few partners and goods.** Bhutan is a small country, has a narrow resource base, and depends heavily on India in regard to trade and development.¹² The dominance of India in Bhutan's trade results from the country's landlocked location and mountainous topography, which makes building and maintaining roads costly and impedes efficient trade logistics. The country's dependence on imports has resulted in a chronically imbalanced foreign trade situation. In 2018, exports accounted for 58% of imports. India received about 78% of Bhutan's total exports, while about 84% of Bhutan's imports originated from India.¹³ Since it was first issued in 1974, the ngultrum has been officially pegged to the Indian rupee at par. The government therefore has to maintain sufficient international reserves, mainly in United States dollars and Indian rupees, to meet foreign currency liabilities including debt repayment, financing imports, and contingencies.

13. **Increased fiscal pressure.** The envisaged resource envelope of the 12th plan, including current and capital expenditures, will increase from the previous plan by 38%, but foreign grants and domestic resource mobilization have not kept pace. During FY2014–FY2018, the composition of government revenue has been stable with, on average, 70% of total revenue accruing from domestic sources and the remaining 30% from international grants.¹⁴ The existing tax regime is characterized by low tax rates, a narrow tax base, and numerous tax incentives. The tax–GDP ratio over the 12th plan period is expected to decline because of hydropower project delays and because India will stop refunding excise duty to Bhutan starting in FY2020. The government has adopted a public finance management strategy that prioritizes mobilizing domestic revenue to compensate for the expected decline in external grants.¹⁵ In November 2017, the government established a macroeconomic stabilization fund to manage volatility.

14. **Governance and institutional capacity.** A well-functioning governance system is essential to realize the principles of Bhutan's development philosophy of Gross National Happiness and to minimize socioeconomic and environmental vulnerabilities.¹⁶ Bhutan's transition from an absolute monarchy to a constitutional democratic monarchy in 2008 was peaceful and stable. However, the government urgently needs to address lingering central and local governance issues to make project planning and implementation more effective. Project implementation by the central government is at times impeded by inadequate coordination among the ministries concerned. Local public servants need encouragement, capacity strengthening, and greater self-confidence to take initiative.

B. Spatial and Social Disparities

15. **Geographical disparities.** Income inequality at the national level has worsened slightly since 2012. The Gini coefficient increased from 0.36 in 2012 to 0.38 in 2017. Uneven infrastructure distribution and public service delivery, which are essentially a result of difficult topography, mainly caused the inequality. Because Bhutan's population is scattered across a diverse and difficult terrain, access to economic opportunities varies significantly. This is evident in Bhutan's uneven poverty incidence, with the highest poverty rate of 33.3% in Dagana district in the south compared to the lowest of 0.3% in Paro district near the capital city of Thimphu. Because

¹² India has been Bhutan's biggest development partner, contributing on average about 70% of total grant inflows during FY2008–FY2018.

¹³ Government of Bhutan, Ministry of Finance. 2018. [Bhutan Trade Statistics 2018](#). Thimphu.

¹⁴ Government of Bhutan, Ministry of Finance. 2019. [National Revenue Report: Fiscal Year 2017–2018](#). Thimphu.

¹⁵ Government of Bhutan, Ministry of Finance. 2017. [Bhutan: Public Financial Management Reform Strategy 2017–2021](#). Thimphu.

¹⁶ The scope of good governance includes rule of law, responsibility, reliability and predictability, openness, transparency, accountability, effectiveness, cooperation (partnership), coherence, and efficiency.

of limited domestic air connectivity, the southern and eastern regions have little access to regional and global markets.

16. Deficiencies in links to external and internal markets. Within the country, poor transport infrastructure, including farm-to-market roads and market infrastructure, impedes Bhutan's agriculture sector and the development of value chains. As for external links, Bhutan will benefit from developing seamless regional transport corridors and streamlining border-crossing procedures. This will reduce the transit time for goods. Bhutan has the weakest logistics performance among the eight member countries of the South Asia Subregional Economic Cooperation (SASEC). Its ranking on the SASEC logistics performance index dropped from 4th in 2010 to 5th in 2012 and 7th in 2014, 2016, and 2018.¹⁷

17. Gender issues. Gender inequality remains a concern. Women have not shared equitably in the progress on the Human Development Index. In 2018, the United Nations Development Programme Human Development Report ranked Bhutan 117 of 189 countries on the Gender Inequality Index. The relatively low ranking is underlined by the low representation of women in parliament and the low supply of jobs for women with secondary education. ADB's gender mainstreaming focus has addressed gender issues in different sectors that were identified in a gender equality diagnostic study.¹⁸ Although the government in its 12th plan strongly commits itself to promoting gender equality, resources for gender-responsive interventions appear insufficient. Therefore, Bhutan needs to strengthen the institutional capacities of both central and local government agencies in analyzing gender issues. Based on such analyses, the government can then take adequate corrective actions, including mainstreaming gender equality systematically in sector policies and programs.

18. Mismatch between the educational system and the demand of the job market. The overall low unemployment rate in Bhutan masks the challenges posed by low labor productivity. The agricultural labor force is engaged in informal and low-wage work with no fringe benefits and limited access to social insurance and skill development programs. The high youth unemployment rate is attributable to a mismatch between the educational system and labor market demand, insufficient investment in technical and vocational education and training (TVET) to meet industry standards, and the poor quality of training. Limited availability of a skilled workforce also hampers the country's investment climate.¹⁹ Secondary schools do not teach the skills that the labor market demands. They have also not taught the types and levels of skills that would improve workforce productivity and economic competitiveness. Improving TVET and tertiary education will help reduce youth unemployment. Opportunities exist to scale up cottage and small industries (CSIs) in the manufacturing (particularly agribusiness) sector and in the natural resources and ICT sectors, all of which have high potential for creating jobs.

19. Rapid urbanization and urban development. According to the 2017 population and housing census, 37.8% of Bhutan's population lives in urban areas.²⁰ Consequently, the country's economic success depends significantly on the performance of urban areas, and disparities in the urban economy affect the competitiveness of the entire country. Urban sprawl and uneven

¹⁷ World Bank. 2018. [Logistics Performance Index 2018](#). Washington, DC.

¹⁸ ADB. 2014. [Bhutan: Gender Equality Diagnostic of Selected Sectors](#). Manila. This study identifies new challenges including unemployment, labor shortages in agriculture, and the difference in living conditions and opportunities between rural and urban areas. There are gender dimensions to each of these challenges, prompting the government and its development partners to mainstream gender in policies, programs, and projects.

¹⁹ World Bank. 2017. [Investment Climate Assessment of Bhutan: Removing Constraints to Private Sector Development to Enable the Creation of More and Better Jobs](#). Washington, DC.

²⁰ Government of Bhutan, National Statistics Bureau. 2018. [2017 Population and Housing Census of Bhutan](#). Thimphu.

population distribution at the periphery of Bhutan's major towns have led to increased daily travel needs and trip frequencies. The limited availability and coverage of public transport and the lack of good sidewalks have prompted commuters to depend on private cars, which creates traffic congestion. The process of urbanization has brought about three interrelated issues, which await remedial policy actions: the need to improve (i) connectivity and urban planning, (ii) land availability and housing affordability, and (iii) resilience to natural disasters and the effects of climate change.

20. **Environmental sustainability, climate change, and disaster risk.** Bhutan is a net sink for greenhouse gases.²¹ Bhutan committed to being carbon neutral by 2008, and with this, the Constitution mandates that a minimum of 60% of the country's total land area be kept under permanent forest cover.²² However, global climate change threatens the economy in the medium term. Climate change is expected to cause glacial retreat, which over time will reduce the river discharge from glaciers, on which Bhutan's hydropower plants depend. The country is vulnerable to natural disasters including earthquakes, landslides, rainstorms, windstorms, and forest fires. Economic progress has also caused rapid lifestyle changes, while environmental policy implementation lags. Consequently, there are new challenges to providing social services, water security, and waste management in both rural and urban areas.²³

III. COUNTRY STRATEGY FRAMEWORK

A. Lessons from Previous Strategy

21. The CPS, 2019–2023 builds on lessons identified in the final review of the CPS, 2013–2018 and its validation by the Independent Evaluation Department (IED), which rated the ADB program *successful at the borderline*. The IED validation acknowledged that ADB programs have made valuable contributions by aligning with government priorities and by ADB's strategic continuity, which has enabled it to achieve reforms that need time to take root. Specifically, the validation recommended the following actions be considered in the new CPS: (i) develop a well-coordinated strategy to support the country's economic diversification objectives; (ii) provide continued support in finance and public sector management, based on expressed demand, to extend the framework and governance reforms already underway; (iii) intensify analytical work on the anticipated social stresses created by skewed economic growth; (iv) undertake a local government sector assessment; and (v) accelerate the establishment of a fully functioning Bhutan Resident Mission.

B. National Development Strategy

22. The 12th plan, approved in December 2018, has the overarching objective of creating a just, harmonious, and sustainable society through enhanced decentralization (footnote 3). This objective is underpinned by principles of leaving no one behind, narrowing the gap between the rich and poor, and ensuring equity and justice. The priorities of the 12th plan are reflected in 17

²¹ Greenhouse gas sink refers to the removal of greenhouse gases or carbon dioxide from the atmosphere.

²² According to the second national greenhouse gas inventory, the estimated sequestration capacity of Bhutan's forests is 6.3 million tons of carbon dioxide, while the emissions in 2000 were low at 1.6 million tons of carbon dioxide equivalent, largely because of huge areas of forest cover, low levels of industrial activity, and almost 100% electricity generation through hydropower.

²³ One of the issues identified is that the urban population does not have round-the-clock access to water supply. Thimphu, Phuentsholing, Damphu, and Bajo have only 8 hours/day of drinking water supply. Government of Bhutan, Gross National Happiness Commission. 2018. [Eleventh Five Year Plan 2013–2018: Final Report](#). Thimphu.

national key result areas (NKRAs), which aim to strengthen the country's socioeconomic foundation and make it resilient to risks associated with continued rapid transformation. The national priorities include diversifying the economy, with a focus on creating jobs and promoting the private sector while also alleviating poverty and vulnerability, creating livable human settlements, sustaining carbon neutrality and climate resilience, and closing infrastructure gaps. The NKRAs align with both the country's development philosophy of maximizing Gross National Happiness, and with the Sustainable Development Goals (SDGs).²⁴ The 12th plan sets specific country-level targets and defines plans to deliver programs and allocate resources.

23. The total expenditure outlay of the 12th plan, including current and nonhydropower capital expenditures, have increased from the previous plan by 38% to Nu310 billion. However, the government's projected resource mobilization (domestic tax and nontax revenues, and grants) is likely to fall short of the anticipated expenditure growth. As a result, the 12th plan estimates a large financing gap of Nu29.2 billion, which will have to be bridged by domestic and external borrowings from multilateral development partners including ADB, the World Bank, and the multilateral South Asian Association for Regional Cooperation Development Fund (SDF). The estimated gap excludes grants committed by the Government of India worth Nu45 billion over the plan period, and Nu16.7 billion from other bilateral development partners, including the European Union, the governments of Japan and Austria, and UN agencies.

C. Role of Development Partners

24. The total official development assistance, in both grants and concessional loans, accounted for 36.5% of government expenditure on average during the 11th plan period (FY2014–FY2018).²⁵ India is the country's largest development partner, providing grants to build and maintain infrastructure in the transport, education, and health sectors.²⁶ Both the Government of India and Indian private investors are the government's main counterparts in investing in large hydropower plants. After the Government of India, ADB has the largest program among the multilateral and bilateral partners. Currently, ADB is the only multilateral development partner investing in hydropower projects, which are of medium size (25–150 megawatt capacity). As of December 2018, ADB's ongoing portfolio totals \$314.48 million, covering diverse areas—infrastructure (agriculture, energy, transport, and urban development) and social sectors (health and skills development). ADB provides a wide range of technical assistance (TA) to (i) strengthen the technical capacity of government agencies in managing natural resources, (ii) strengthen public financial management and economic analysis, and (iii) promote a better business climate.

25. The World Bank's program totals \$60 million on policy-based programs for fiscal management reforms and private sector development. After its establishment in 2010, SDF engagement was initially limited to social sector projects. In 2018, the SDF broadened its operations to include infrastructure investments. The various agencies of the UN provide grant assistance to the government across diverse development areas, including climate change and mitigation, disaster preparedness, public health, democratic governance, fiscal decentralization, and gender equality. The priorities of the Japan International Cooperation Agency are agriculture, rural development, and bridge construction. The European Union provides technical support for governance and public financial management, and budget support to the agriculture sector. The

²⁴ Gross National Happiness commenced in 1998 and comprises four pillars: sustainable and equitable socioeconomic development, preservation and promotion of culture conservation, sustainable utilization and management of the environment, and good governance.

²⁵ Government of Bhutan, Ministry of Finance. 2018. [Annual Financial Statements 2017–2018](#). Thimphu.

²⁶ On average, grants from India serviced about 23.1% of total expenditure per annum during FY2008–FY2018.

Government of Austria provides support to fiscal decentralization and renewable natural resources. Appendix 2 summarizes the assistance provided by these development partners.

26. The MOF is the focal agency for ADB, the World Bank, and the SDF, whereas the Gross National Happiness Commission is the focal agency for the UN and bilateral development partners. The government, in collaboration with the UN system in Bhutan, holds a biennial round table meeting to conduct a high-level policy dialogue between the government and its development partners.²⁷ The UN also organizes bimonthly meetings of development partner groups to discuss development coordination among partners. Government agencies and civil society organizations are occasionally invited to the meetings to deliberate on specific items on the development agenda.

D. ADB's Strategic Objectives and Operational Priorities

27. **Country partnership strategy objective.** ADB will foster economic diversification and reduce spatial and social disparities. The strategy will rest on three strategic pillars that will address the development challenges of structure-induced vulnerabilities and disparities, including (i) dynamic economic reforms to foster a resilient and diversified economy, (ii) improved connectivity to provide better access to information and markets, and (iii) greater inclusiveness through more equitable socioeconomic development. The three pillars are closely aligned with 11 out of 17 NKRA of the government, including economic diversification; reducing poverty and inequality; carbon neutrality and climate and disaster resilience; quality of education and skills; food and nutrition security; infrastructure, communication, and public services; gender equality; productive and gainful employment; a healthy and caring society; sustainable human settlements; and sustainable water. The CPS priorities are also aligned with all SDGs except for SDGs 12, 14, 15, and 16.²⁸

28. **Alignment with Strategy 2030.** The CPS strategic objectives and operational priority areas align with all seven operational priorities of Strategy 2030 (table). To ensure development effectiveness, ADB will select themes, areas, and projects that build on previous operations to support government priorities, while aiming to provide integrated solutions that combine areas of expertise across a range of sectors and themes. The majority of the country portfolio will entail high-impact and large-scale infrastructure projects, which will enable the country to address remaining poverty and reduce inequalities (operational priority 1 [OP1]). ADB's planned portfolio will also support efforts to make cities more livable (OP4), promote rural development and food security (OP5), and foster regional cooperation and integration (OP7). To complement these investments and address structural imbalances and disparities, ADB will support the government in strengthening governance and institutional capacity (OP6) by adopting and implementing critical reforms through policy-based reform programs. ADB will assist the government in promoting the use of advanced technologies and, to this end, provide complementary capacity-building development and carry out pilot testing of eligible projects. ADB will continue its engagement in a focused manner based on its comparative advantages in the sectors of agriculture, education and skills development, and health. ADB will promote gender equality (OP2), respond to climate change, build climate and disaster resilience, and enhance environmental sustainability (OP3) across all operations.

²⁷ The government organized the 14th Round Table Meeting during 12–14 March 2019 in Thimphu, Bhutan. More than 100 participants representing more than 50 development partners attended the meeting.

²⁸ SDG1: no poverty; SDG2: zero hunger; SDG3: good health and well-being; SDG4: quality education; SDG5: gender equality; SDG6: clean water and sanitation; SDG7: affordable and clean energy; SDG8: decent work and economic growth; SDG9: industry, innovation, and infrastructure; SDG10: reduced inequality; SDG11: sustainable cities and communities; SDG13: climate action; and SDG17: partnership for the goals.

Three Pillars of ADB Country Partnership Strategy: Bhutan, 2019–2023

Pillar 1—Reforms: Dynamic Economic Reforms for a Resilient and Diversified Economy	Pillar 2—Connectivity: Improved Connectivity for Better Access to Information and Markets	Pillar 3—Inclusiveness: Greater Inclusiveness through More Equitable Socioeconomic Development
<p>a. Support policy-based programs for a resilient and diversified economy (aligned with OP1 and OP6)</p> <p>Promote private investments through policy reforms to diversify financial sector and deepen financial inclusion</p> <p>b. Support institutional reforms to improve sector efficiency (aligned with OP3 and OP6)</p> <p>Support sector reforms to improve institutions' capacity for innovative financing, design and management of infrastructure projects</p> <p>Support policy reforms to promote development of alternative renewable energy sources</p> <p>c. Promote private sector development and operations (aligned with OP1 and OP6)</p> <p>Support business development services to promote new sectors with potential for job creation</p> <p>Promote PPP to leverage financing for public investment and secure public assets</p>	<p>a. Improve transport connectivity (aligned with OP1 and OP7)</p> <p>Enhance air connectivity to lagging regions</p> <p>Improve subregional road connectivity among Bangladesh, Bhutan, India, and Nepal</p> <p>Support climate and disaster resilient transport network</p> <p>b. Improve regional integration and cooperation (aligned with OP1, OP3, and OP7)</p> <p>Develop infrastructure (other than transport) to support trade facilitation and enhance customs administration</p> <p>Develop hydropower generation capacity to increase cross-border trade</p> <p>Improve digital connectivity to foster regional integration</p> <p>c. Connect farmers to markets and regional and global value chains (aligned with OP1, OP5, and OP7)</p> <p>Improve feeder and rural farm roads to facilitate access to markets</p> <p>Increase agricultural productivity and food security</p>	<p>a. Build smart, green, and livable cities (aligned with OP1–OP4)</p> <p>Improve urban infrastructure and services, including waste and pollution management systems</p> <p>Promote green and efficient public transportation, and improve road safety</p> <p>Develop primary and secondary towns</p> <p>b. Promote human development (aligned with OP1–OP2)</p> <p>Ensure skills trainings match with market demand</p> <p>Facilitate access to job information, and improve delivery of services to remote areas through ICT</p> <p>Improve equity, efficiency, and financial sustainability of the health care system</p> <p>c. Promote gender equality (aligned with OP2)</p> <p>Promote economic empowerment of women</p> <p>Strengthen capacity of central and local government agencies, National Commission of Women and Children, and gender focal points to implement gender mainstreaming programs</p>

ICT = information and communication technology, OP = operational priority, OP1 = addressing remaining poverty and reducing inequality, OP2 = accelerating progress in gender equality, OP3 = tackling climate change and disaster resilience and enhancing environmental sustainability, OP4 = making cities more livable, OP5 = promoting rural development and food security, OP6 = governance and institutional capacity, OP7 = fostering regional cooperation and integration, PPP = public-private partnership.

Source: Asian Development Bank.

29. ADB will use the One ADB approach that embraces close collaboration between ADB's sovereign and nonsovereign assistance and between operations and knowledge departments. ADB assistance will adopt a country-focused approach that values environmental preservation, the well-being of Bhutan's people, and economic prosperity. ADB will provide predictable and substantial long-term financing for physical investments, coupled with capacity development to promote reliable, green, and efficient access to public services, markets, and employment opportunities for the disadvantaged, while building climate and disaster resilience and enhancing environmental sustainability.

Pillar 1: Dynamic Economic Reforms for a Resilient and Diversified Economy

30. This pillar advocates reforms and developing capacity to promote a competitive and effective market and business environment. The harnessing of new priority areas, such as CSIs, sustainable eco- and community-based tourism, and commercial agriculture will generate new sources of income and improve competitiveness.

31. **Supporting policy-based programs for a resilient and diversified economy.** Availability of affordable finance is a major impediment to private investments and doing business in Bhutan (footnote 18). This support, therefore, aims to deepen and broaden the finance sector. The ADB assistance will (i) strengthen the regulatory and supervisory framework, (ii) implement risk management measures, and (iii) develop a well-functioning public debt market that can serve as a reliable and effective source of domestic financing. ADB will also help diversify the finance sector and promote financial inclusion by strengthening the regulatory framework and the capacity of nonbank financial institutions, including insurance companies, pension and provident funds, microfinance institutions, and stock and commodity markets.

32. **Supporting institutional reforms to improve sector efficiency.** ADB will help strengthen government institutions and build human capacity to help the government manage investment projects more efficiently. The assistance will support sector reforms through improved project management mechanisms, advanced technologies, innovative forms of financing, transparency and anticorruption initiatives, and skills development in the design and management of infrastructure projects. In the energy sector, for example, ADB will help the government to reform policies to promote efficient use of energy and invest more in alternative renewable energy sources, including solar power, biogas, and wind power. ADB will harness the carbon market to help the hydropower industry perform better financially, and to increase fiscal resources.

33. **Promoting private sector development and operations.** ADB will help promote private sector development by implementing reforms that remove private sector impediments and create a better enabling business environment. Policy-based reforms will aim to strengthen the effectiveness of public–private consultation and promote new priority sectors with high potential to contribute to job creation, e.g., CSIs and tourism. The support will also provide business development services, including market links, branding, and access to incubation facilities. ADB will promote public–private partnerships to leverage financing for public investments and to secure public assets.

Pillar 2: Improved Connectivity for Better Access to Information and Markets

34. Under this pillar, ADB will support deeper regional cooperation and integration by improving physical connectivity; facilitating logistics, information, and trade; and enabling the country to accommodate increasing levels of tourism and trade more efficiently. Because it participates in the SASEC program, Bhutan can leverage competitive regional cooperation and integration initiatives to promote international trade. ADB will continue supporting the SASEC program. Pillar 2 will also help farmers gain better access to local and international markets.

35. **Improving transport connectivity.** ADB will help Bhutan invest sustainably in climate resilient land and air transport networks to enable people and goods to travel reliably and efficiently. ADB will continue to enhance the capacity and safety of the three domestic airports—Bumthang, Gelephu, and Yongphula—located in less-developed regions in the south and the east, which will also help reduce spatial disparities. Through the SASEC program, ADB will support Bhutan in achieving better subregional road connectivity under the Bangladesh, Bhutan,

India, and Nepal transport connectivity initiative. The initiative will allow passengers and freight vehicles to cross international borders and travel along designated key trade routes in the four countries.

36. **Improving regional integration and cooperation.** To complement its interventions in transport, ADB will help develop infrastructure that will facilitate trade and enhance customs administration. The assistance will improve the efficiency of the dry port in Phuentsholing, Bhutan's main border-crossing point, where ADB has already invested significantly in the urban, transport, trade, and health sectors. Bhutan participates in multilateral and regional integration initiatives but could still benefit from deeper regional integration. ADB will support initiatives that leverage regional cooperation programs to increase competitiveness and provide access to larger markets. Because it produces a net surplus of hydropower, the hydropower industry can help Bhutan to increase cross-border trade with other SASEC members. ADB will also explore investments that make cross-border information and communication networks more reliable. Improved digital connectivity will not only foster regional integration but also improve service delivery to remote areas and thus facilitate administrative decentralization.

37. **Connecting farmers to markets and regional and global value chains.** Through sovereign and nonsovereign investments and TA, ADB will help farmers and rural poor people to increase agricultural productivity and food security. The assistance covers integrated transport modes that facilitate access to markets by improving feeder and rural farm roads. ADB assistance will also address the water–food–energy security nexus, integrated flood risk management, agricultural water efficiency and productivity, and water governance.

Pillar 3: Greater Inclusiveness Through More Equitable Socioeconomic Development

38. ADB's assistance will help strengthen skills and give economic opportunities to vulnerable groups, including young entrepreneurs, women, youth entering the job market, and rural and urban poor people. The program will provide TA and investments to improve education and skills. It will help the government to deliver health care more efficiently and equitably, promote gender equality, and improve the quality of life for people in towns and cities. ADB will continue supporting the Health Sector Development Program that became effective in January 2019 and the Skills Training and Education Pathways Upgradation Project that became effective in the first quarter of 2019.²⁹ Supplementary TA will help strengthen the capacity of the executing and implementing agencies.

39. **Building smart, green, and livable cities.** Rapid urbanization has hindered the government's ability to provide urban services, such as safe water supply, sanitation, and other basic amenities. ADB will help municipalities to enhance the livability, safety, and sustainability of main urban areas by improving physical amenities and infrastructure, such as roads, footpaths, drainage, drinking water, and public transport. ADB will help the government develop proper settlement plans and improve waste and pollution management systems. ADB will also help the government to implement green and efficient public transportation and to enhance road safety. The currently inadequate public transport system has created traffic congestion and has degraded air quality by increasing greenhouse gas emission. ADB's Office of Public–Private Partnership

²⁹ ADB. [Bhutan: Health Sector Development Program](#), Manila; ADB. [Bhutan: Skills Training and Education Pathways Upgradation Project](#), Manila.

has provided TA to the government to develop the Thimphu integrated bus terminal as a pilot public–private partnership project.³⁰

40. **Promoting human development.** During the CPS period, ADB will help implement the two ongoing social sector projects that were approved in 2018. First, the Skills Training and Education Pathways Upgradation Project will help students gain better access to skills development and will equip students enrolled in TVET with skills that match market demand.³¹ ADB assistance will promote innovation and ICT by using an integrated management information system and an employment service portal. The assistance will also promote green technology and modern teaching and training pedagogy. ADB will help the private sector to deliver training courses that are in demand in the market. Second, ADB will support government efforts to improve the equity, efficiency, and financial sustainability of the health care system. This will help to eliminate remaining poverty and inequality, while improving health security.³² ADB will invest in upgrading primary health care facilities to deliver services more inclusively, especially in currently neglected areas. ADB will help the government to finance health equitably and to manage the Bhutan Health Trust Fund sustainably. The fund is mandated to support primary health care by financing vaccines and essential medicines. ADB will also help the government improve how it manages and governs Bhutan’s health information system. This will improve service delivery, including patient record management, disease surveillance, and interoperability of data, which will also improve the overall efficiency of health sector management.

41. **Promoting gender equality.** ADB will continue to support gender mainstreaming in operations and empower women in economic activities by undertaking detailed gender assessments. Gender action plans are prepared, monitored, and reported for projects that have significant potential to mainstream gender concerns or that are likely to have a substantial gender impact. ADB will continue providing support to the National Commission of Women and Children by strengthening its capacity and improving the quality and reach of its services. ADB will continue to build the capacity of the network of gender focal points to strengthen gender mainstreaming across sectors and districts. ADB will continue its gender mainstreaming and women’s empowerment support in the design of its operations by undertaking project-specific gender analyses and by developing project-specific gender action plans to overcome persisting disparities. In ADB priority sectors, ADB will support relevant government central and local government agencies with gender-related capacity development. Under ADB-financed operations, the country team will explore opportunities to empower women through renewable energy, entrepreneurship, craftsmanship, and agriculture market access.

42. **Private sector operations.** ADB will expand and broaden its private sector operations in line with CPS priorities. Throughout the CPS period, the country team will pursue One ADB approach of close collaboration between its regional and private sector operations departments. To complement sovereign lending operations, ADB’s private sector operations will explore strategic investment opportunities with state-owned enterprises that help develop downstream industries, including in tourism, agribusiness, and logistics. ADB will continue to explore opportunities to improve accessibility to finance in Bhutan by providing capital to eligible financial institutions. This will help to develop small and medium-sized enterprises and agriculture, while addressing other priorities such as access to energy and affordable housing in urban and rural areas.

³⁰ This is supported by ADB. [Technical Assistance for Strengthening Project Preparation Capacity in Asia and the Pacific: Supporting Preparation of Infrastructure Projects with Private Sector Participation in Asia Pacific \(Subproject 4\)](#). Manila.

³¹ ADB. [Bhutan: Skills Training and Education Pathways Upgradation Project](#). Manila.

³² ADB. [Bhutan: Health Sector Development Program](#). Manila.

43. Through its private sector operations' Trade Finance Program, ADB helps close market gaps in trade finance by providing banks with guarantees and loans that finance cross-border trade and thereby promote economic diversification. ADB will also provide complementary support to small and medium-sized enterprises through the Supply Chain Finance Program by assuming corporate risk for trade payables and receivables. The assistance will include a continuous program of training to domestic bank staff to deepen product knowledge and minimize risk. Similarly, through the Microfinance Risk Participation and Guarantee Program, ADB will explore opportunities for TA designed to build a robust microfinance subsector. Covering both microfinance institutions and commercial banks in Bhutan, the TA will support product design and operational risk management, while ensuring that lenders respect client protection principles and adopt fair lending practices.

E. Priorities for Knowledge Support

44. ADB will enhance the development impact of its program by delivering operationally relevant knowledge products in close coordination with the government, other development partners, and national entities. The scope of knowledge generation will align with the three pillars of the CPS. ADB will support the government in diversifying Bhutan's economy through interventions backed by analytic work. ADB will give special attention to identifying policy reforms and investments that will facilitate (i) expansion of the economic base and growth drivers, and (ii) integration with regional and global value chains. Together with other development partners and national entities, ADB will engage in policy dialogues on governance, operation and maintenance of infrastructure, investment climate improvements, diversification, tariff reforms, service delivery, and gender mainstreaming. The Bhutan Resident Mission will act as the custodian of ADB-supported knowledge work, but when preparing knowledge products and services (KPSs) the mission will embrace a One ADB approach to ensure that those KPSs fully benefit from contributions of sector divisions and knowledge departments.

45. ADB will help address the development challenges by linking the country operations business plan and the country knowledge plan with the CPS (Appendix 2). ADB will also optimize the value addition from sector and thematic groups in the context of cross-sector solutions for development challenges. Country operations will selectively integrate lessons from IED and will engage the Department of Communications for appropriate planning, budgeting, and dissemination of knowledge products. ADB will regularly carry out knowledge work to inform future national development plans.

IV. STRATEGY IMPLEMENTATION

A. Indicative Resource Parameters

46. Bhutan, a group A developing member country, is eligible for concessional ordinary capital resources lending (COL). Bhutan can also access Asian Development Fund (ADF) disaster risk reduction allocation for concessional assistance countries. The indicative resources for commitments during 2020–2022 total \$232.56 million, including \$15.00 million in ADF grant and \$30.00 million in COL from the disaster risk reduction financing mechanism under ADF 12.³³ The resource envelope is significantly larger than that of the previous CPS, the increase being based

³³ ADB. 2016. *Supporting Disaster Risk Reduction*. Paper prepared for the second ADF XII replenishment meeting. Kathmandu. 24–27 February. Funding from the disaster risk reduction financing mechanism will support incremental costs in strengthening the disaster resilience of infrastructure investments.

on the outcome of the country performance assessment completed in September 2018. In that assessment, Bhutan scored the highest among group A developing member countries. The 2018 debt distress classification of Bhutan was assessed to be at moderate risk of debt distress. The existing cost-sharing arrangements will continue to apply, with ADB financing covering up to 99% of loan project costs on an overall portfolio-wide basis.³⁴

B. Implementation Priorities

47. **Ensuring efficient project implementation.** ADB will ensure project readiness and strengthen project implementation. During the project design and preparation stage, ADB will adhere to strict project readiness criteria, including establishing a project implementation office recruiting staff early, commencing the land acquisition and resettlement process, completing advanced procurement actions, and developing suitable indicators for monitoring implementation progress. ADB will provide complementary TA to improve the efficiency of project administration, including financial management and procurement. In addition to the annual tripartite portfolio review meeting, ADB will hold regular individual meetings with project implementation and executing agencies to review project progress and resolve potential implementation challenges.

48. **Ensuring synergy between sovereign and nonsovereign operations.** ADB's nonsovereign operations will continue to be aligned with the national priorities covered under the three strategic pillars of the CPS. Specifically, they will continue to support interventions in agribusiness, finance, hydropower, and tourism. Nonsovereign interventions to promote small and medium-sized enterprises will be channeled through financial institutions. ADB will address key challenges that it faces in providing nonsovereign assistance to Bhutan, including a contractual framework that is mutually acceptable to all parties.

49. **Collaborating with development partners.** ADB will explore opportunities to collaborate with the Japan International Cooperation Agency in infrastructure investments. The partnership with the World Bank and the International Monetary Fund to support macroeconomic and public financial reforms will be sustained and strengthened. ADB will explore opportunities to collaborate with UN agencies in developing the human capital and tackling climate change and natural resource management.

C. Monitoring of Results

50. The CPS results framework (Appendix 1) maps the alignment of projected CPS results with (i) selected NKRA's of the government's 12th plan for 2018–2023, and (ii) specific operational priorities under ADB's Strategy 2030. Most indicators of the CPS results framework are identical with the ones used by the government to track progress against specific NKRA's. The remaining indicators are sector or project outcome indicators and international indexes. The ADB country team, in collaboration with government agencies, will monitor and report these indicators when they are available during country portfolio review and country programming missions. ADB will align its program with the government priorities and update the results framework to confirm and modify the country program.

³⁴ Actual cost sharing will be determined by project-specific considerations and be justified during the economic and financial due diligence.

D. Risks

51. **Procurement.** Bhutan faces moderate to substantial procurement risks. It has the lowest corruption perceptions in the region, but its public and private sector capacity levels remain low.³⁵ Public sector procurement often has a narrow focus on awarding the lowest bid, resulting in projects of poor quality. Procedural reforms are needed to place greater focus on the technical responsiveness of bids. Executing agencies should assign more staff to engage in procurement. The private sector also needs greater capacity to engage in public works. ADB will introduce measures to (i) attract international bidders that can compensate for the low levels of domestic capacity, and (ii) deal with increasing public and private sector investments.

52. **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. ADB is expanding operations but involved government agencies have limited capacities. Consequently, portfolio performance will be under further pressure. This risk will be mitigated by (i) appropriately sizing projects to align with the capacity of the agencies; (ii) mainstreaming capacity development in project design, management, and implementation; (iii) forging long-term partnerships by seeking clear, up-front commitments for strong leadership and retention of key staff; and (iv) providing systematic support for on-the-job training with oversight of results.

53. **Financial management.** Bhutan's public financial management system is relatively strong, and the inherent financial management risk is considered lower than in other developing member countries in the region. The 2016 public expenditure and financial accountability assessment reported notable improvements and reforms from the previous assessment (2010). However, the lowest scores were given to accounting and reporting, government transparency, and budget reliability. Consequently, the government is implementing a public finance management reform action plan that covers five reform measures, with three of those measures already fully implemented: (i) developing a government performance management system, (ii) developing a web-based inventory and revenue administration management system, and (iii) establishing a separate revenue intelligence and investigation division.³⁶

54. ADB-assisted projects will continue to use the country systems for public financial management whenever these meet ADB requirements. In this regard, ADB will prepare project financial statements in accordance with the government's accounting laws and regulations, to be audited by the Royal Audit Authority in accordance with the International Standards of Supreme Audit Institutions. Opportunities for ADB to add value and further improve the public finance management systems and practices may include (i) building capacity of selected government employees, especially at the local level, in project financial management and ADB procedures; (ii) building capacity of the Royal Audit Authority to further improve timeliness and the quality of project audit reports; and (iii) strengthening the effectiveness of internal audits.

³⁵ Bhutan ranks 25th out of 180 countries in Transparency International's 2018 Corruption Perception Index.

³⁶ The remaining two measures are still being implemented. First, a core team of professionals is integrating the Civil Services Information System and the payroll system, which will be completed by end FY2020. Second, the planning and monitoring system has yet to be integrated with the multiyear rolling budget system and the public expenditure management system. In completing these five public finance reforms, the government will significantly improve how it manages and delivers public services.

COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

Country Development Impact Indicators with which the CPS is Aligned^a				
1. Annual average real GDP growth rate: 5.0%–6.0% during 2019–2023 (2013–2018 baseline: 5.9%) 2. Multidimensional poverty: less than 5.0% by 2023 (2017 baseline: 5.8%) 3. Gini coefficient: less than 0.38 by 2023 (2017 baseline: 0.38)				
CPS Strategic Objectives	Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
Dynamic economic reforms for a resilient and diversified economy	Supporting policy-based reform for a resilient and diversified economy (aligned with OP1 and OP6)	Greater contribution of nonhydropower industries to the economy	Growth rate of nonhydropower industries revenue: 15% by 2023 (average of 12% in 2013–2018) ^a	Ongoing portfolio: As of 31 December 2018 Sovereign loan projects Number: 10 Amount: \$285.2 million Nonsovereign projects Number: 1 Amount: \$3.0 million Planned operations and contribution (3-year pipeline as per latest COBP): Sovereign Lending (\$307.0 million of COL plus \$20.0 million of ADF grant for DRR mechanism for 2019–2022) Technical assistance Nonlending (\$2 million per year)
	Supporting institutional reforms to improve sector efficiency (aligned with OP3 and OP6)	Increased access to finance by the private sector	Credit to micro and CSI enterprises as a percentage of total credit increased to 20.0% by 2023 (2018 baseline: 15.8%)	
Improved connectivity for better access to information and markets	Promoting private sector development and operations (aligned with OP1 and OP6)	More efficient use of energy	Energy auditing and reporting guidelines adopted and implemented by 2023 (2018 baseline: 0) ^a	
	Improving transport connectivity (aligned with OP1 and OP7)	More efficient project procurement	Criteria for maintaining list of quality vendors, contractors, and consultants developed for screening by 2023 (2018 baseline: 0)	
		Greater participation of the private sector in development projects	Successful commercial closing of at least two new PPP infrastructure contracts during 2019–2023 (2009–2018 baseline: three projects)	
Improved connectivity for better access to information and markets	Improving access to regional integration and cooperation (aligned with OP1, OP3, and OP7)	Improved transport connectivity with climate and disaster resilience design features	Percentage increase in public transport ridership during the Twelfth Five-Year Plan period: 10.00% by 2023 (Eleventh Five-Year Plan baseline: 1.07% by 2017) ^a	
	Connecting farmers to markets and regional and global value chains (aligned with OP1, OP5, and OP7)	Increased cross-border power trade and domestic electricity access	Power exports increased to 3,000 MW by 2023 (2018 baseline: 1,614 MW)	
		Efficient trade facilitation	World Economic Forum's Enabling Trade Index above 4 during 2019–2023 (2018 baseline: 4)	
		Improved digital connectivity	Inclusive Digital Index reaches 6.5/10 by 2023 (2017 baseline: 3.8/10) ^{a, c}	

CPS Strategic Objectives	Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
		Enhanced livelihood of rural communities	Food insufficiency reduced to 2.4% by 2023 (2017 baseline: 6.2%) ^{a, d}	
Greater inclusiveness through more equitable socioeconomic development	<p>Building smart, green, livable cities (aligned with OP1–OP3, and OP4)</p> <p>Promoting human development, including skills development and health sector development (aligned with OP1–OP2)</p> <p>Promoting gender equality (aligned with OP2)</p>	<p>Improved delivery of clean, reliable and sustainable water services</p> <p>Increased access to quality and relevant skills development</p> <p>Achieved more equitable access to, greater efficiency of, and improved financial sustainability of the health system</p> <p>Promoted transformative gender agenda; addressing gender-based violence, unpaid care and domestic work; and access to economic resources and opportunities</p>	<p>Households with metered connections to the water distribution system increased to 70% by 2023 (2018 baseline: 55%)^b</p> <p>TVET graduates employed within 6–12 months of graduation to reach 85% by 2023 (2017 baseline: 80%)^a</p> <p>National immunization coverage of children sustained at 95% during 2019–2023 (2018 baseline: 95%)^b</p> <p>New measures introduced to overcome gender discrimination and address issues related to transformative gender agenda: at least two by 2023 (2018 baseline: 0)</p>	

ADB = Asian Development Bank, ADF = Asian Development Fund, COBP = country operations business plan, COL = concessional OCR lending, CPS = country partnership strategy, CSI = cottage and small industry, DRR = disaster risk reduction, GDP = gross domestic product, MW = megawatt, OP = operational priority (under ADB's Strategy 2030), OP1 = addressing remaining poverty and reducing inequality, OP2 = accelerating progress in gender equality, OP3 = tackling climate change and disaster resilience and enhancing environmental sustainability, OP4 = making cities more livable, OP5 = promoting rural development and food security, OP6 = governance and institutional capacity, OP7 = fostering regional cooperation and integration, PPP = public–private partnership, TVET = technical and vocational education training.

^a National or agency key result area indicators under the Government of Bhutan, Gross National Happiness Commission. 2018. [Twelfth Five Year Plan \(2018–2023\)](#). Thimphu.

^b Indicators from sectors or projects (including technical assistance).

^c The indicator measures following aspects of ICT: (i) mobile cellular telephone subscriptions per 100 inhabitants, (ii) international internet bandwidth per Internet user (Bit/u), (iii) percentage of households with computers, (iv) percentage of households with Internet access, (v) percentage of individuals using the Internet, (vi) fixed (wired) broadband subscriptions per 100 inhabitants, and (vii) active mobile broadband subscriptions per 100 inhabitants.

^d The indicator measures the percentage of households that experienced food insufficiency in the country in the last 12 months (i.e., that did not have enough food to feed all household members).

Sources: Asian Development Bank; and Government of Bhutan, Gross National Happiness Commission. 2018. [Twelfth Five Year Plan \(2018–2023\)](#). Thimphu.

COUNTRY KNOWLEDGE PLAN

A. Knowledge Needs

1. **Objective.** The country knowledge plan (CKP) aims to create knowledge assets that guide and improve the quality of the proposed investments and reform programs of the Asian Development Bank (ADB). Over the country partnership strategy (CPS) period (2019–2023), Bhutan needs substantial assistance in the form of policy advice and capacity building to achieve timely and effective reforms and project implementation. ADB needs to scale up knowledge work to help the government identify and implement reforms to maintain a sustainable and inclusive growth trajectory. The scope of knowledge generation will align with the three pillars of the CPS.

2. **Principles.** The CKP will follow the principles of pro-client, proactive, practical, and partnership. The knowledge work will be pro-client based on the government's demand to design timely reform programs. ADB will perform knowledge work proactively by tapping its experiences from repository country and regional knowledge to produce policy notes derived from sector diagnostics and topical analyses. The assistance will be practical because the government will be able to use knowledge products in both implementing ongoing projects and preparing pipeline projects with high-quality design and readiness. The knowledge production and dissemination will leverage partnerships with internal partners using the One ADB approach and with external partners, including government institutions, local and regional think-tanks, and development partners. All knowledge products and dissemination activities will incorporate innovation and forward thinking.

B. Scope of ADB's Planned Knowledge Operations

3. **Value addition.** ADB is Bhutan's largest multilateral development partner, with a total ongoing portfolio of \$285.2 million that covers comprehensive investments and reforms, including investments in infrastructure (energy, transport and trade facilitation, and urban development) and the social sectors (health, skills development, and education). Consequently, ADB's knowledge transfers, good practices, and the innovations of its projects and programs strongly improve Bhutan's development outcomes. ADB has transformed institutional arrangements in some of the key sectors in which it has assisted. For example, through programs that strengthen institutions and capacities, ADB has helped the government to restructure the energy sector, reform regulations, and enable public sector utilities to become more commercially oriented and recover costs. ADB will incorporate both institutional and technological innovations into its projects. This will include introducing innovative financing and incorporating advanced design, building, and maintenance of infrastructure assets (roads, water and waste management, and airport upgrade and operation).

4. ADB also adds value through regional knowledge work and policy dialogue under the South Asia Subregional Economic Cooperation (SASEC), initiated in 2001. To date, the majority of regional assistance received by Bhutan has been in renewable energy projects. Bhutan will play a key role in realizing the SASEC vision's flagship program on cross-border power trade, as its surplus hydropower is already being tapped to meet the rising power demands of neighboring SASEC countries. Bhutan has also tapped into regional resources and knowledge in social sectors such as health, transport, and trade facilitation. ADB will promote opportunities to share

knowledge and experience with Bhutan and other regional and nonregional developing member countries.

5. **One ADB approach.** Bhutan will continue to benefit from numerous regional, SASEC, and ADB-wide technical assistance (TA) facilities managed and provided by (i) the South Asia Department's sector divisions; knowledge departments, such as the Economic Research and Regional Cooperation Department and Sustainable Development and Climate Change Department; and other departments handling specific areas of governance, such as the Controller's Department; (ii) the Office of the General Counsel; (iii) the Office of Anticorruption and Integrity; and (iv) the Procurement, Portfolio, and Financial Management Department. In addition, the Office of Public–Private Partnership and Private Sector Operations Department provide capacity building and advisory TA to promote public–private partnerships and financial facilities to promote private sector development.

6. **Integrated approach.** ADB will optimize the scope of knowledge interventions to address development challenges by linking the CPS adequately with the country operations business plan and the CKP. ADB will also optimize the value addition from sector and thematic groups in the context of cross-sector solutions for development challenges. Country operations will integrate feedback from the Independent Evaluation Department and engage the Department of Communications for appropriate planning, budgeting, and dissemination of knowledge products. ADB will regularly carry out knowledge production with the aim of creating a knowledge plan that can inform future national development plans.

7. **Alignment with Strategy 2030 and operational priority plans.** ADB aims to expand the development impact of its operations by delivering knowledge products and services (KPSs) and by coordinating closely with the government and other development partners and stakeholders. The country team will align the KPSs with the seven operational plans of Strategy 2030 using a variety of TA modalities, including cluster TA or TA facility, transaction TA, small-scale TA, and knowledge and service TA. A knowledge team chaired by the country director of the Bhutan Resident Mission will manage CKP implementation. The KPSs will comprise diverse formats, including flagship studies and events (Asian Development Outlook); technical studies, such as sector or thematic assessments, working papers, policy briefs, and opinion articles; and other supplementary knowledge products such as case studies, tool kits, learning modules, journal articles, and project implementation guides.

8. A summary of potential knowledge products emerging from the diagnostic country assessment is in the following table.

Planned Knowledge Support for 2019–2023

Priorities Areas	Operation Plan	Knowledge Products
Pillar 1—Reform: Dynamic economic reforms (aligned with OP1, OP3, and OP6)		
Policy-based support for a resilient and diversified economy	OP1 and OP6	(i) Design and implementation of key regulatory and institutional reforms, application of good practices, sequencing of reforms, and capacity building for successful reform implementation. (ii) Policy advice to deepen the scope and strengthen the governance of the overall finance sector, including AML/CFT.
Institutional reforms to improve sector efficiency	OP3 and OP6	(i) Diversification of energy generation, energy efficiency, and reduction in greenhouse gases through energy improvements in the energy, transport, and urban sectors. (ii) Capacity assessment and enhancement of local governments to ensure successful implementation of projects and programs.

Priorities Areas	Operation Plan	Knowledge Products
		(iii) Capacity building to help local governments deliver services effectively and efficiently, particularly through ADB-supported urban development projects.
Promoting private sector development and opportunities	OP1 and OP6	(i) Policy advice and capacity building to design and implement PPP projects, piloting selected projects, and advisory services. (ii) Knowledge building on size and capabilities of the national contracting industry and options for enhanced employment.
Pillar 2—Connectivity: Improved connectivity (aligned with OP1, OP5, and OP7)		
Improved transport connectivity	OP1 and OP7	Promotion of good practices in procurement and financial management, and use of advanced technology and management methods for improved road and air connectivity.
Improved access to regional integration and cooperation	OP1	(i) Policy advice and capacity building to simplify trade documentation, increase automation, and expedite border clearance procedures to facilitate efficient movement of goods and vehicles. (ii) Facilitation of bilateral and regional coordination mechanisms and knowledge sharing such as technology transfer and development practices toward the regional power trading market and cross-border power agreement.
Connecting farmers to markets and regional and global value chains	OP1, OP2, OP5, and OP7	(i) Capacity building for stakeholders and beneficiaries on packaging designs and market links. (ii) Use of technology to store knowledge and manage logistics for transporting agricultural products to the markets. (iii) Irrigation systems, water, and land management. (iv) Rural roads' operation and maintenance.
Pillar 3—Inclusiveness: More equitable socioeconomic development (aligned with OP1–OP4)		
Smart, green, and livable cities	OP1–OP4	(i) Integrated and sustainable urban planning, use of advanced technology for operations in delivering reliable water supply, wastewater treatment, geographic information systems, and hydraulic modeling. (ii) Policy advice and investments in green public transportation, affordable housing, and municipality institutional development. (iii) Infrastructure standards to promote safety, climate resilience, and energy efficiency. (iv) Policy advice on sustainable and spatial tourism development targeted towards employment generation and improving the livelihoods of rural communities. (v) Showcasing Bhutan's experience in environment conservation and climate change, and efforts towards remaining carbon neutral, in line with the nationally determined contributions and their implementation.
Skills development	OP1–OP2	(i) Evidence-based advice, through consultation with the private sector, to develop employment and demand-driven TVET (youth education diagnostics and labor market studies).
Health sector development	OP1–OP2	Capacity building for the financial management of the Bhutan Health Trust Fund and application of project management for efficient implementation of ongoing health sector development programs.
Promoting gender equality	OP2	(i) Policy advice on transformative gender agenda, including combating gender-based violence, addressing unpaid care and domestic work, and promoting access to economic resources and opportunities. (ii) Integration of gender perspectives in knowledge solutions and capacity development in ADB operations.

ADB = Asian Development Bank, AML/CFT = anti-money-laundering and combating the financing of terrorism, OP = operational priority, OP1 = addressing remaining poverty and reducing inequality, OP2 = accelerating progress in gender equality, OP3 = tackling climate change and disaster resilience and enhancing environmental sustainability, OP4 = making cities more livable, OP5 = promoting rural development and food security, OP6 = governance and institutional capacity, OP7 = fostering regional cooperation and integration, PPP = public–private partnership, TVET = technical and vocational education training.

Source: Asian Development Bank.

C. Areas of Collaboration with Partners

9. ADB will enhance the leverage potential of country operations by collaborating with partners and other stakeholders, including local think-tanks and academic institutions, in planning, programming, and delivering knowledge services and products, as well as in encouraging wider knowledge sharing and exchange. The engagement of civil society organizations will strengthen the impact of ADB's policy advice about beneficiaries. ADB will closely coordinate its knowledge operations with all development partner organizations active in Bhutan and the SASEC region. Given the various anticipated macroeconomic and public finance reforms, ADB will closely coordinate its advisory services on priority key reforms (finance sector, private sector development, and public administration reforms) with the International Monetary Fund and the World Bank Group. ADB will scale up and improve on past experience from other development partners (the United Nations, development partners, and international nongovernment agencies) who have experimented with small-scale pilot projects in rural development, water management, and entrepreneurship and youth development.

D. Resource Allocation

10. ADB expects to provide about \$10 million to generate knowledge products and services for Bhutan during 2019–2023 through staff input, staff consultancy, country-specific assistance, and regional TA projects. A dedicated team, supervised by the country director of ADB's Bhutan Resident Mission, will monitor the implementation of the CKP. The Bhutan Resident Mission will process and implement a TA facility that will help (i) generate policy advice for and transfer analytical knowledge to the government for effective implementation of reform programs; (ii) build the capacities of the implementing and executing agencies of ADB projects in designing and implementing ongoing and pipeline projects; and (iii) promote public awareness to a broader audience including the private sector, project beneficiaries, civil society organizations, and the media on ADB reform programs, knowledge products, and development results achieved. ADB will also use the TA facility resources to leverage tacit knowledge from ongoing investment projects by producing useful operation manuals. These operation manuals will promote efficient project implementation covering the areas of procurement, financial management, auditing, and safety. In addition to country-specific assistance, the country team will use the findings of the regional TA projects by the South Asia Department and other knowledge and special departments in assisting the government. Trust funds, cofinancing from development partners, and cost sharing with the government will support the proposed knowledge work.

E. Knowledge Competence or Expertise

11. In its national planning process, Bhutan has incorporated a unique Gross National Happiness development philosophy, in close alignment with the Sustainable Development Goals. Bhutan can share its experience in effectively enforcing an environmental sustainability policy, including the requirement for environment impact assessments. ADB will explore ways to produce new knowledge products that will synthesize the statistical and conceptual work from the Gross National Happiness Index. Those knowledge products could be useful to other developing member countries. Of potential use to other developing member countries is Bhutan's commitment to climate agreements, which reaffirms its commitment to remain carbon neutral. ADB can support a knowledge-sharing seminar with the objective of scaling up and replicating Bhutan's experience in other countries. ADB can also help the government in assessing the country's progress in achieving its development goals, including the Sustainable Development Goals and the Voluntary National Reviews, using tools like the Inclusive Green Growth Index; and strengthening the country's capacity in data collection, analysis, management, and dissemination.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/CPS/?id=BHU-2019>

1. Inclusive and Sustainable Growth Assessment
2. Development Coordination Matrix
3. Indicative Country Operations Business Plan