

Bhutan

Making Progress on the Path to Prosperity



Asian Development Bank



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Making Progress on
the Path to Prosperity

Development Effectiveness Brief

Asian Development Bank

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Bhutan and ADB: Working Together for Poverty Reduction

Suk Bdr Darjee, 17, is a hardworking student of Dagana Higher Secondary School. His parents are both farmers and are not earning enough to finance their children's education. Determined to succeed in life, Darjee takes on part-time jobs every school winter break.

At present, Darjee works as a laborer for a local contractor involved in the construction of a roadside wall for the Dagachhu hydropower plant. He saves the money that he earns and uses it to pay for his school fees, books, and food expenses. "Since last year, I have been able to finance my own education.

I don't have to depend on my poor parents," he says.

"If the project wasn't started here, finding employment would have been really difficult for us. We would have to go far away from our village to look for jobs," Darjee says. Many young Bhutanese in Dagana are employed as office aides, laborers, night guards, and security personnel at the project site.

By being actively engaged in community work, young people like Darjee get to enjoy financial freedom while developing a sense of purpose and responsibility as well. "In some ways, I have become more

Bhutan Development Indicators

Non-Millennium Development Goals		Millennium Development Goals	
Population in millions (2012)	0.7	Population living on less than \$1.25 (purchasing power parity) a day (%) (2007)	10.2
Annual population growth rate (%) (2010–2012)	1.3	Population living below the national poverty line (%) (2012)	12.0
Adult literacy rate (%) (2012)	55.3	Under-5 mortality rate per 1,000 live births (2011)	54.0
Population in urban areas (%) (2012)	33.7	Population using an improved drinking water source (%) (2012)	98.0

Sources: ADB. 2013. *Basic Statistics 2013*. Manila; ADB. 2013. *Key Indicators for Asia and the Pacific 2013*. Manila; National Statistics Bureau and ADB. 2013. *Bhutan Living Standards Survey 2012 Report*. Manila; National Statistics Bureau. 2012. *Statistical Year Book of Bhutan 2012*. Thimphu.



The Dagachhu hydropower development, under the Green Power Development Project, has provided jobs to young Bhutanese like Suk Bdr Darjee, who works part-time as a laborer to finance his education.

Photo by Kezang Namgay

independent and more helpful to my parents by working at the construction sites of the project,” Darjee says.

Hydropower development brings significant economic benefits to Bhutan. At the national level, it generates revenues that promote and sustain the country’s economic growth. At a more local level, communities benefit from business and job opportunities generated by hydropower development. The Dagachhu

hydropower development is part of ADB operations in Bhutan.

Despite its geographical challenges and limited linkage to the global markets, Bhutan has managed to ignite and sustain high economic growth by unlocking its hydropower potential. Bhutan successfully reduced poverty incidence from about 32% in 2003 to about 12% in 2012 as a result of its robust economic growth, with an average annual growth rate of more than 8.5% in 2003–2012.

Loan and Grant Approvals in Bhutan (\$ million)

	1983–2006	2007	2008	2009	2010	2011	2012
OCR	–	–	51.00	–	–	–	–
ADF	176.06	19.70	54.28	38.76	21.59	19.87	18.59
Total	176.06	19.70	105.28	38.76	21.59	19.87	18.59

Loan and Grant Disbursements in Bhutan (\$ million)

	1983–2006	2007	2008	2009	2010	2011	2012
OCR	–	–	–	8.06	21.02	15.09	5.95
ADF	103.42	8.91	7.07	27.58	38.11	26.84	33.53
Total	103.42	8.91	7.07	35.64	59.13	41.93	39.48

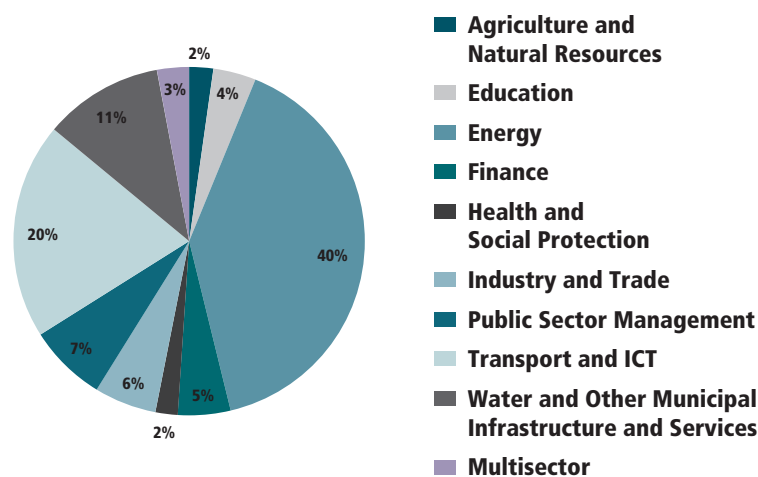
ADF = Asian Development Fund, OCR = ordinary capital resources.

Source: Asian Development Bank.

ADB has been a key partner since 1982 when Bhutan joined ADB, and today it has become the country's largest multilateral development partner. Since the first loan approval of \$5 million in 1983, ADB has provided 29 loans and 16 grants totaling \$486.29 million as of 30 November 2013. ADB assistance to Bhutan has been mainly financed through the Asian Development Fund (ADF), which is a concessional financing window for its developing member countries.

To be in line with the government's development agenda, energy, finance, transport, and urban development became the key sectors of ADB operations in Bhutan under the previous country strategy and program 2006–2010, and they have remained so

Asian Development Bank Loans and Grants to Bhutan by Sector (as of 30 November 2013)



ICT = information and communication technology.

Source: Asian Development Bank.



Community e-centers, supported by ADB's SASEC Information Highway Project, are helping young people learn computer skills and programming.

Photo by Eric Sales/ADB

ADB has been accelerating its regional cooperation and integration program in Bhutan to enhance cross-border connectivity and trade under the South Asia Subregional Economic Cooperation Program and other related initiatives

since then. Venturing into newer areas of support, ADB has also provided assistance in civil aviation, information and communication technology, and trade facilitation since 2007. ADB has been accelerating its regional cooperation and integration program in Bhutan to enhance cross-border connectivity and trade under the South Asia Subregional Economic Cooperation Program and other related initiatives.

ADB Contributions to Development and Poverty Reduction

ADB has assisted the government in achieving high economic growth and reducing poverty by providing support to enhance, among other things, rural electrification, hydropower development, road connectivity, provision of urban infrastructure and services, and financial sector development.

Between 2006 and 2012, ADB-funded projects installed 1,260 kilometers (km) of transmission lines and 1,770 km of distribution lines and brought electricity to more than 17,000 households. In transport, 346 km of national highways and roads were constructed or upgraded with ADB assistance, which brought benefits to about 97,000 people by enhancing accessibility.

More recently, according to the project completion reports circulated in 2013, ADB's credit line funded 1,900 subloans for small and medium-sized enterprises while ADB projects built or upgraded an additional 202 km of national highways and roads.

Energy: Harnessing Hydropower Potential


Power generation in Bhutan relies almost exclusively on hydropower. The country is endowed with a hydropower potential of around 30,000

Development Outputs from ADB-Supported Projects in Bhutan

Sector/Outputs	Outputs Achieved (2006–2012)
Education	
Classrooms built or upgraded (number)	75
Teachers trained (number)	84
Students benefiting from school improvement programs or direct support (number)	3,063
Energy	
Transmission lines installed or upgraded (kilometers)	1,260
Distribution lines installed or upgraded (kilometers)	1,770
New households connected to electricity (number)	17,296
Greenhouse gas emission reduction (tons of carbon dioxide equivalent per year)	2
Transport	
National highways and provincial, district, and rural roads built or upgraded (kilometers)	346
Beneficiaries from road projects (number)	97,000

Note: Outputs delivered were based on project completion reports circulated in 2006–2012.

Source: Asian Development Bank.



Construction work continues at the Dagachhu hydropower plant, the world's first cross-border clean development mechanism project.

Photo by Kezang Namgay

megawatts (MW). Of this, 23,760 MW is technically feasible while the current total installed hydropower generating capacity is only 1,488 MW.

About 70% of total power generated is exported to India. Power exports account for the largest source of national revenue in the form of taxes and dividends, generating about 30%–40% of government revenue. The power industry and related construction works make up one-third of gross domestic product. Hydropower development and export have, therefore, steadfastly underpinned rapid growth of Bhutan's economy and generated government resources for social and

other investments. Accelerating the development of hydropower for export is, thus, of strategic significance to the Bhutanese economy.

Since the provision of ADB's first lending program in the sector in 1995, energy has been one of the key sectors of ADB operations in Bhutan. As of 30 November 2013, ADB has provided six loans and four grants totaling \$194.77 million, accounting for the largest share (about 40%) of ADB's lending portfolio in the country. While continuing to provide support for enhancing rural electrification, ADB has increased its support for hydropower and renewable energy development since 2006 and has been

a critical partner of Bhutan in its hydropower development.

To accelerate hydropower development in a sustainable manner, ADB helped the government prepare the Sustainable Hydropower Development Policy. One of the key objectives of the policy was to promote public, private, and foreign investments to accelerate the development of hydropower generation in a competitive manner.

With the hydropower development policy in place, the governments of Bhutan and India signed the Protocol to the 2006 Framework Agreement to incorporate the enhanced development target of 10,000 MW from 5,000 MW by 2020.

Under the Green Power Development Project (loans 2463 and 2464 and grants 119 and 141, \$106.28 million from ADF, Asian Clean Energy Fund, and ordinary capital resources, approved in 2008), ADB also provided support for the development of the 126 MW run-of-river type Dagachhu hydropower plant as the first public-private partnership infrastructure project in Bhutan through an innovative financing mechanism. It is expected to be commissioned in 2014 after the completion of construction work by the end of 2013.

The Dagachhu hydropower project was also registered as the world's first cross-border project that applied for the clean development mechanisms under the United Nations Framework Convention on Climate Change. This would allow the project to earn salable certified emission reduction credits, which could be counted toward Kyoto targets.

ADB has increased its support for hydropower and renewable energy development since 2006 and has been a critical partner of Bhutan in its hydropower development

“The Dagachhu hydropower project is the world's first cross-border clean development mechanism project, so it is a very special project,” says Thinley Dorji, chief executive officer of the Dagachhu Hydropower Corporation. The certified emission reduction will be equal to the amount of electricity exported, he explains. He projects that Bhutan will be able to generate almost 500,000 certified emissions reductions per year. “Through the certified emissions reductions, we will be generating a substantial amount of additional funds,” he says.

The Green Power Development Project also has a rural electrification component. The electrification investment has been completed and provides electricity to 8,886 households and public facilities, including schools, health clinics, and community centers, in remote rural areas by extending an existing grid and through the use of off-grid solar home systems.

The importance of the Green Power Development Project was signified by its receipt of the United States Department of the Treasury's Impact Honors award in July 2013, along with four other international development projects from multilateral development banks. The Green Power



Living conditions for Passang Wangmo and her family have improved after power was installed in their house in Dagana district.

Photo by Kezang Namgay

Development Project was recognized for its outstanding project design and implementation, which exemplified a well-designed initiative that simultaneously meets the goals of economic growth, rural development, and environmental protection.

Passang Wangmo and her family are among many who have benefited from ADB support in the energy sector. Passang lives with her ailing parents and a younger brother in Tsendagana *gewog* (village block) in Dagana district, about 150 km from the capital, Thimphu. Both her parents suffer from respiratory ailments.

“To a large extent,” says Passang, “I believe their sickness was caused

by many years of exposure to smoke and soot from indoor cooking. They are always coughing and suffer from breathing problems.” Before power was installed in their house, Passang’s family used kerosene lamps for light and cooked their meals in traditional hearths using firewood.

From the time her family began receiving electricity in their district, Passang noticed a significant improvement in her parents’ health condition. “My parents are less exposed to smoke as we use the hearth for cooking only when the light goes off. So they are now breathing cleaner air,” she adds. They also do not have to go through the trouble of fetching



ADB road projects have made a substantial impact on economic growth and connectivity in Bhutan.

Photo by Eric Sales/ADB

firewood or kindling a fire every time they cook, and can now save the money they used to spend on kerosene. “Electricity has made our lives so much easier,” she says.

Homes with electricity, including Passang’s, not only provide a healthier living environment, but are also more conducive for learning and accessing information. “Today with electricity, my brother can study for longer hours.” Passang and her parents are pinning the family’s hopes on her brother. “I am confident that he will become somebody one day and lift us from the abject poverty that we are in. Electricity

has not only lighted up our home but has given us this hope as well,” she remarks.

Transport: Connecting for Better Lives

The development of Bhutan’s transport sector is constrained by the combination of a landlocked, mountainous terrain and a small and scattered population. This makes the building and maintenance of vital infrastructure, particularly the road network, very costly. The Gross

National Happiness Commission's *Tenth Five Year Plan (2008–2013) Mid Term Review Report*, released in 2011, revealed that accessibility still poses the biggest challenge in the transport sector.

Bhutan currently has a road network of 10,578 km, comprising 2,436 km of national highways and expressways, 1,190 km of feeder or district roads, 5,257 km of rural farm roads, 350 km of urban roads, 667 km of forest roads, and 678 km of other access roads. Road transport is the dominant mode of transportation within Bhutan and with neighboring Indian states. There is no railway system in the country.

Bhutan's vehicle fleet, concentrated in Thimphu and Phuentsholing, has also grown rapidly from only 13,600 registered vehicles in 1997 to 62,707 in 2012. The development of the road network has not been able to meet the growing demands of vehicles, particularly of larger and heavier vehicles, because of the rapid growth.

Recognizing these major concerns, ADB has been providing assistance to (i) enhance the main road network, especially of the southern East–West highway; (ii) develop and strengthen the road asset management system; (iii) improve road safety conditions; (iv) provide capacity strengthening in modern road technology; (v) improve subregional road connectivity with neighboring countries, including transit facilities and logistics; and (vi) enhance safety, capacity, and security at the airports. As of 30 November 2013, ADB has provided four loans and three grants to the transport sector totaling \$92.78 million. This comprises 19% of its investment portfolio, representing the second-biggest sector of ADB operations in Bhutan.

Under the Road Network Project I (loan 2187, \$27.3 million ADF, completed 2011), about 136 km of the national highway between Gelephu and Tongsa was strengthened and 16 km of bypass and 66 km of feeder roads were constructed. The project completion report notes that the improvement of roads resulted in a reduction in travel time by 23% and vehicle operating costs by 18%, on average. Average walking distance for the relevant villages along the project feeder roads was also reduced from 3.26 km to 1.27 km.

The enhanced road network has contributed to improving access to basic services. For instance, the number of children who were not attending school due to remoteness declined from 8.7% in 2007 to 3.1% in 2012. Similarly, the percentage of the rural population not consulting health care providers due to lack of transport fell from 30.7% in 2007 to 0.4% in 2012. Moreover, the improved road conditions have substantially improved farmers' access to fairly priced markets while stimulating agricultural development through expanded production of cash crops.

ADB also provided the Farm Roads to Support Poor Farmers' Livelihoods Project (grant 9146, \$3 million from the Japan Fund for Poverty Reduction, approved 2010) to develop priority farm roads connecting isolated rural communities and farms to feeder roads constructed under the Road Network Project I. Solid progress has been registered in constructing 25 km of farm roads in two poor *gewogs* (blocks of villages) in Chukha and Trashigang districts. The project is also providing support to develop the capacity of local communities to



The upgraded East–West highway has opened up business opportunities for local entrepreneurs like restaurant owner Zam Rinzin.

Photo by Kezang Namgay

manage and maintain these roads and to enhance rural farmers' agriculture and marketing capacity.

In the areas of policy reforms and institutional development, ADB helped the government develop the Bhutan Transport 2040 Integrated Strategic Vision in 2011 with financial support from the Australian Agency for International Development. This was to set the long-term development direction of the country's transport sector. ADB also provided support to enhance the capacity of the Department of Roads and Road Safety and Transport Authority for road safety audits, and the capacity of the Department of Roads in road asset management under the Capacity Building in Road Safety and Road Asset Management Project (TA 4658, \$0.3 million, completed 2010).

Apart from shortening travel hours, decreasing transport costs, and

improving accessibility, ADB support to the road network expansion in Bhutan has also enhanced business and job opportunities in local communities.

The number of small shops along the East–West highway has mushroomed, and they are flourishing from the steady influx of travelers and motorists. Zam Rinzin, 44, runs a 4-year-old restaurant–bar in Nobding, a dusty roadside settlement along the highway, some 40 km from Wangdue Phodrang in western Bhutan.

ADB support to the road network expansion in Bhutan has also enhanced business and job opportunities in local communities

Noting the changes brought to Nobding by the improved road, she says, “the number of travelers has increased compared to the past. A few years back, the number of vehicles plying on this road was very few. Now every few minutes, a motor vehicle passes by. The road has been widened and there are definitely more people traveling today. Thanks to the better road condition and a greater number of vehicles driving through, local entrepreneurs like us benefit a lot.”

Making more than 200,000 ngultrum (Nu) a year is no longer an enormous task for this lady entrepreneur. “For me, this highway is a source of livelihood,” she says. Today, she comfortably sends her three children to school and spends money on other household costs. For Zam, this kind of change is more than welcome.

Finance: Preparing for Opportunities

Bhutan’s financial sector still remains small and predominantly bank-based, though it has been experiencing rapid development. Under the Tenth Five Year Plan, 2008–2013, finance was considered one of the three critical sectors for Bhutan’s economic development, along with infrastructure and energy, given that the financial sector plays a key role in facilitating private sector participation in economic growth.

Being one of Bhutan’s main partners in financial sector development, ADB has, together with the government, made concerted efforts to develop a well-functioning financial system in the country that can support private sector development and a broad-

ADB has, together with the government, made concerted efforts to develop a well-functioning financial system in the country that can support private sector development and a broad-based development model

based development model. ADB has provided assistance in building (i) a sound legal and regulatory framework, (ii) functioning supervisory and member financial institutions, (iii) diversified financial products, and (iv) the necessary market infrastructure to meet the country’s economic development needs. As of 30 November 2013, ADB assistance to the financial sector includes five loans totaling \$23.5 million, accounting for about 5% of ADB’s investment portfolio.

The ADB-financed Financial Sector Development Program (loans 2279 and 2280, \$13 million ADF, completed in 2012), for example, contributed to strengthening the governance of the financial system by adopting key regulatory and capital market legislations, strengthening corporate governance, improving anti-money-laundering measures, and unifying accounting and reporting standards.

Through the Financial Sector Development Program, the revised Royal Monetary Authority (RMA) Act and the Financial Services Act were passed in 2010 and 2011, respectively.



Since the 1968 establishment of the Bank of Bhutan, the country's first financial institution, Bhutan's financial system has experienced rapid development.

Photo by Kezang Namgay

The revised RMA Act improved the RMA's autonomy by allowing it to function as an independent central bank with a governance structure in line with international best practices. The Financial Services Act ensured that Bhutan would have a complete legal framework for the entire financial sector and empower the RMA as its sole regulator.

The establishment of the credit information bureau, the reconstitution of the Accounting and Audit Standards Board, and the issuance of new licensing regulations that facilitated the entry of two new commercial banks

and one new insurance company were also accomplished under the Financial Sector Development Program.

The deputy governor of the RMA, Eden Dema, said that ADB assistance was critical, since the Bhutanese financial system was at a juncture when the economy was developing at a rapid pace with an increased demand for financial services. According to her, in the absence of a financial sector master plan and financial experts in the country, the development of the financial system would not have reached the current level without ADB support.

ADB also financed the Micro, Small, and Medium-Sized Enterprise (MSME) Sector Development Program (grants 0088 and 0089, \$15 million ADF, completed in 2012), which promoted private sector development on a broader scale and enhanced the development of the MSME sector, in particular. ADB support to the sector was aligned to the government's goals of broadening its economic base and enhancing employment opportunities for a growing labor force.

Under the MSME Sector Development Program, the government established policies, strategies, and an institutional framework for promoting MSME development. It adopted the MSME Policy, Strategy, and Action Plan in 2012, taking the national MSME development agenda to a higher level. According to the project completion report, the program also contributed to enhancing business laws and regulations whereby the government implemented a regulatory impact assessment methodology in 2011, reduced business formalization time from 62 days to 36 days, and made it easier for small businesses to obtain micro-trade registration certificates.

Another key contribution of the MSME Sector Development Program was enhanced access to market-based finance. ADB's credit line funded 1,900 subloans through the Bhutan Development Bank Limited, which increased its lending to micro, small, and medium-sized enterprises, constituting 35% of its portfolio at the end of 2012. A cost-sharing facility, also financed by ADB, funded business development services for 1,651 individuals and enterprises.

Urban Development: Shaping Up Bhutan's Cities

Bhutan has been experiencing rapid urbanization as a result of rural–urban migration. The current rate of population growth in Thimphu, the capital city, is more than 8% per year while it is 3% or higher in Phuentsholing and 18 other regional and provincial centers. The government is expecting that close to half of the population will live in the cities by 2020. This phenomenon has, however, started to strain the provision of basic infrastructure and services in urban areas.

To support the government's efforts to enhance the provision and quality of urban infrastructure and services, particularly for low-income urban dwellers, ADB has financed projects to (i) develop municipal infrastructure, including water supply and sanitation services, solid waste management, and urban roads; (ii) improve urban governance and strengthen municipal planning and management capacities; and (iii) promote cost recovery for urban services and enhance private participation in municipal service delivery. ADB has provided four loans to support urban development totaling \$53.5 million as of 30 November 2013, comprising about 11% of ADB's investment portfolio in the country.

The ADB-financed Urban Infrastructure Improvement Project (loan 1625, \$5.7 million ADF, completed 2005), for example, made a substantial contribution to improvements in health conditions and quality of life of the residents



Rapid urbanization is transforming the skyline of Bhutan's capital.

Photo by Kezang Namgay

of Thimphu and Phuentsholing. According to the country assistance program evaluation that was undertaken by ADB's Independent Evaluation Department in 2010, the key outputs of the project included 12.5 km of improved roads and two bridges, with 8,000 and 900 daily vehicle crossings recorded for each bridge; 13 km of drains; 9.4 km of footpaths; 6 km of river training works; and 20,000 square meters of parking. According to the project completion report, thousands of residents were found to have benefited from better drainage in the project sites, improved traffic flows, a better parking system, and improved footpaths. Since drains were regularly cleaned as part of the project maintenance, the buildup of roadside sludge was eliminated, reducing odor and making footpaths and sidewalks a lot cleaner.

ADB also financed the Capacity Building in Urban Infrastructure

Planning and Management Project (TA 4844, \$0.25 million, completed 2009) to enhance the capacity of the Ministry of Works and Human Settlements, Thimphu and Phuentsholing municipalities, and Dagana. It helped formulate and undertake (i) a solid waste management (SWM) strategy and action plan for Thimphu, (ii) a geotechnical and slope stability study for Dagana,

The ADB-financed Urban Infrastructure Improvement Project made a substantial contribution to improvements in health conditions and quality of life of the residents of Thimphu and Phuentsholing



Rinzin Dema has witnessed the rapid rise of infrastructure in Bhutan's capital, Thimphu.

Photo by Kezang Namgay

(iii) unaccounted-for water reduction and water calibration, and (iv) land pooling and urban facility management advisory. The SWM strategy and action plan were key documents that facilitated the Thimphu municipality's work in SWM, including rehabilitation works on the existing landfill site,

operationalization of the incomplete compost plant, and identifying a location for a recycling center and transfer station and a new landfill site.

Rinzin Dema, 49, is a resident of Thimphu, where she was born and raised. Having lived in the city all her life, Rinzin is an eyewitness to the tremendous changes and development Thimphu has undergone in the last 4 decades. She has seen how the capital has been transformed from a being small, sleepy town into a lively, sprawling city with civic amenities.

"The extent of development that Thimphu has undergone is phenomenal," says Rinzin. "The difference is that of earth and sky. Thimphu was like a small rural village in the old days. There were barely any houses. In the past, many of the places here were either huge swathes of forestland or paddy fields. There was no network of roads. Even the vehicles were few. Getting a taxi was so hard those days." She adds that the development in the city has benefited everyone. "We had nothing those days and today we have access to every kind of facilities," she says. "Life has become much easier after the development. It is more organized and systematic. We have drinking water, electricity, and good roads."

For old-time Thimphu residents like Rinzin, urban development is a welcome change. "When I look back," Rinzin says, "we have leapfrogged from an ancient time to a whole new modern world. Thanks to the efforts of the government and its partners, we live much better lives now than ever before."

Operational and Organizational Effectiveness: Improving Efficiency and Performance

ADB's Independent Evaluation Department rated ADB country operations and programs in Bhutan during 2001–2009 as *successful* in its 2010 country assistance program evaluation. They were found to be well aligned with country development needs, government development priorities, and ADB's long-term strategic framework 2008–2020 (Strategy 2020). The 2010 evaluation noted that ADB operations in Bhutan were effective as most anticipated outputs were delivered as planned.

Between 2006 and 2013, nine project completion reports were prepared for loans and grants completed in Bhutan, all of which had the overall assessment rating of *successful* or *highly successful* and reported tangible development impacts. As for the 15 technical assistance projects that were evaluated, 14 projects were rated *successful* or *highly successful* while one project was rated *partly successful*.

Despite the successful performance of projects in Bhutan, key lessons have also been identified. Under the Finance Sector Development Program (loans 2279 and 2280, \$13 million ADF, completed in 2012), key financial sector legislations were developed and approved. While the delays were

inevitable, the project completion report noted that closer, long-term, in-country dialogue with the government would have been beneficial. Such a dialogue and closer project monitoring will be enhanced by the establishment of an ADB resident mission in Bhutan.

ADB projects and programs in Bhutan have also generally exhibited better portfolio performance than the ADB portfolio as a whole. Both contract awards/commitment ratio (30%) and disbursement ratio (31%) were above the ADB average of 25% and 20%, respectively, in 2012. Two start-up indicators for Bhutan's loan portfolio were also better than the ADB average in 2012: the average time taken from approval to signing was 2.6 months and from signing to effectivity was 2.7 months in Bhutan, both much shorter than the ADB average of 3.8 months and 3.4 months, respectively.

It should, however, be noted that there was a deterioration in the project portfolio performance rating between 2011 and 2012. While all 10 ongoing projects were rated *on track* in 2011, 3 out of 9 projects (33%) were rated as potential problem projects and 1 out of 9 projects (11%) was rated as an actual problem project in 2012, due mainly to

poorer procurement and disbursement performance than projected. This concern was shared with the government during the Tripartite Portfolio Review Meeting conducted in August 2013. The importance of close monitoring on portfolio performance was also emphasized during the meeting.

The 2010 country assistance program evaluation notes that while ADB's assistance program in Bhutan has been implemented in an efficient manner, increasing project volumes and complexities coupled with a lack of counterpart and domestic contractor capacity are likely to pose extra challenges in the future. A greater focus on service delivery in remote rural areas and small towns in recent years has also meant that projects are being implemented by agencies and private contractors who often have little experience with ADB policies and procedures. The evaluation study underscores the importance of strengthening local capacity. More efforts need to be devoted to capacity building in procurement, safeguards, and financial management, particularly for new municipalities and local governments.

To address the above issues, ADB has been providing training in such areas as disbursement and project design for executing and implementing agencies. ADB has also been placing a greater focus on project readiness in project design to avoid implementation delays. Furthermore, the establishment of the resident mission in Thimphu will lead to closer coordination between ADB and the government and help enhance implementation efficiency and development effectiveness.

The establishment of the ADB resident mission in Thimphu will lead to closer coordination between ADB and the government and help enhance implementation efficiency and development effectiveness

Future Challenges

By unlocking its hydropower potential, in recent years Bhutan has managed to transform itself from a closed, subsistence economy into a rapidly growing lower-middle-income country. The high sustained economic growth has helped Bhutan make remarkable progress in reducing poverty and achieving the Millennium Development Goals.

Despite its impressive economic performance, Bhutan continues to face development challenges. The country has a narrow economic base and its growth has been propelled mainly by an externally funded, capital-intensive

hydropower sector that generates limited employment opportunities. As a result, youth unemployment has become a critical issue in Bhutan. Inequality also remains high even through Bhutan managed to reduce poverty incidence to 12%. In addition, the recent Indian rupee liquidity issue has underlined the need to strengthen fiscal, debt, and liquidity management of the country.

ADB's recently completed *Bhutan: Critical Development Constraints* report emphasizes the need for the Bhutanese economy to become broad-based with more diverse growth drivers



Sustaining high and inclusive economic growth remains a major challenge to Bhutan and its development partners.

Photo by Eric Sales/ADB

if Bhutan is to move beyond the lower-middle-income paradigm. According to the report, key constraints to inclusive economic growth include (i) inadequate and poor quality infrastructure, (ii) narrow fiscal space, (iii) lack of access to finance by micro, small, and medium-sized enterprises, (iv) presence of market failures that limit product diversification and competition, and (v) limited and unequal access to quality education and labor market mismatch.

The objective of the government's Eleventh Five Year Plan, 2013–2018 is to achieve “self-reliance and inclusive green socioeconomic development” and the main thrusts are on (i) inclusive social development, (ii) green accelerated economic development, and (iii) strategic infrastructure development. By aligning its next country partnership strategy, 2014–2018 with the Eleventh

Five Year Plan, ADB is fully committed to working closely with the government and people of Bhutan to address new and existing development challenges to promote high, inclusive, and environmentally sustainable growth.

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Bhutan: Making Progress on the Path to Prosperity

Development Effectiveness Brief

Since Bhutan became a member in 1982, the Asian Development Bank (ADB) has provided \$486.29 million in loans and grants and \$54.09 million in technical assistance. ADB has assisted the government in advancing socioeconomic development by providing support to enhance rural electrification, hydropower development, road connectivity, provision of urban infrastructure and services, and financial sector development. ADB remains committed to supporting the Government of Bhutan's efforts toward sustaining high growth and making this growth more inclusive.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people who live on less than \$2 a day, with 828 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.