

BHUTAN: COUNTRY DIAGNOSTIC STUDY

I. Basic Data

A.	Project Officer(s)	Yoko Niimi, Economist, Economic Analysis and Operations Support Division (EREA), Economics and Research Department (ERD)
B.	Executing Agency	Asian Development Bank (ADB)
C.	Prioritized Areas	Inclusive Growth
D.	Types of Outputs	Targeted Assessments, Information Dissemination
E.	Coverage (Country/Regional)	Bhutan
F.	Amount Requested	\$275,000
G.	Implementation Period	October 2010 - September 2011

II. Proposed Project

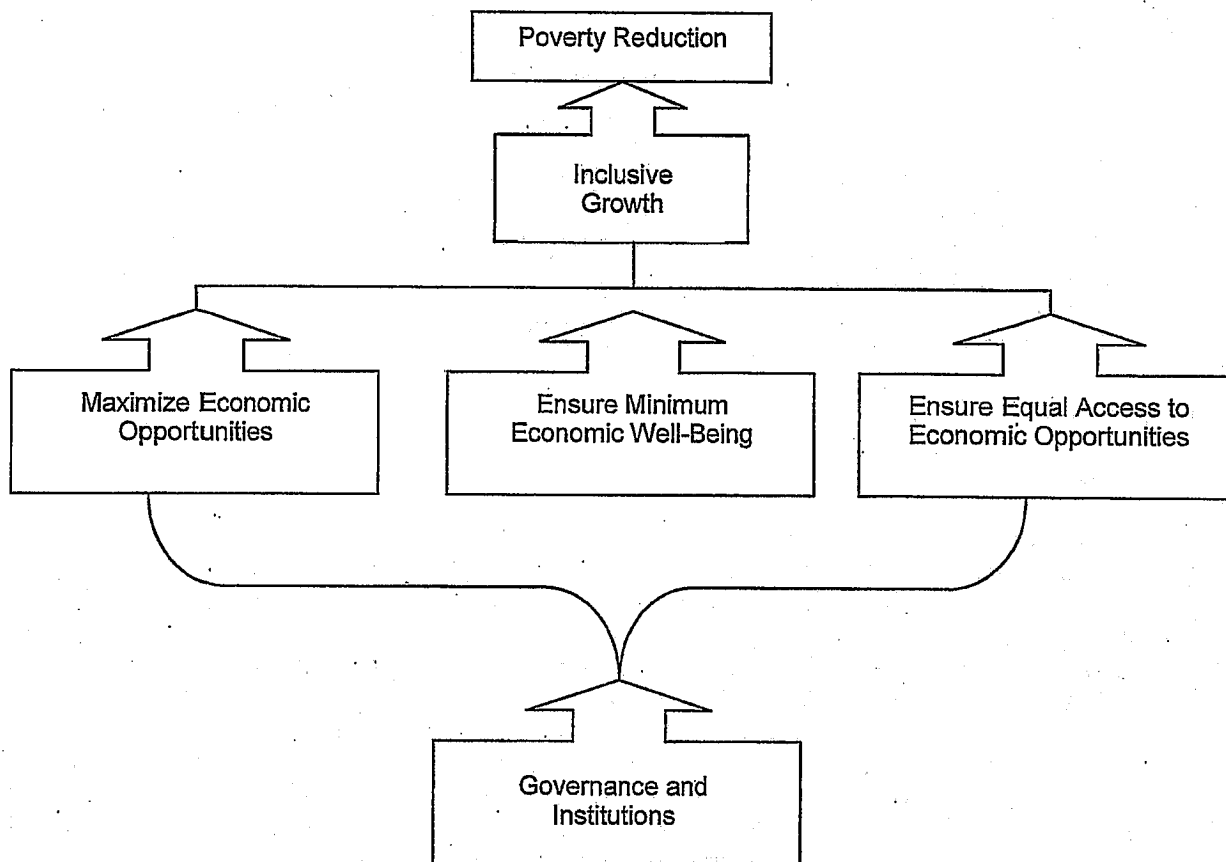
A. Background and Rationale

1. Bhutan's economic performance has been impressive in the last decade thanks to political stability and prudent economic management. Its gross domestic product (GDP) growth averaged about 9.3% per year during 2001-2008, which outperformed that of other South Asian countries, including India. The country was also able to weather the recent global economic crisis. Bhutan has been making steady progress in reducing poverty—the poverty incidence was estimated to have declined to about 23.2% in 2007 from about 36.3% in 2000. However, Bhutan still remains a poor country and inequality continues to be among the highest in the Asia and Pacific. One of the challenges that the country faces is the narrow base of the economy, which is highly dependent on hydropower. While hydropower will continue to be a main driver of Bhutan's economic growth in the coming years, it is likely to generate limited employment opportunities. The Bhutanese government is committed itself, in the Tenth Five Year Plan 2008-2013, to realizing and maximizing Gross National Happiness (GNH) through broad-based and sustained growth and a reduction in poverty and inequality. In order to achieve this goal, Bhutan needs to have broad-based inclusive growth without endangering the environment and its natural resources, and maintaining the country's unique feature of a harmonious society.

2. Inclusive growth is growth that not only generates economic opportunities, but also ensures equal access to these by all members of a society. Hence a development strategy based on the inclusive growth concept is anchored on three pillars: one is to create and expand economic opportunities through high and sustained growth; second is to broaden access to opportunities for all members of a society; and third is to ensure the minimum well-being of the population through the adequate provision of social safety nets, while governance and institutions are a cross-cutting issue (Figure 1). However, like other developing countries, Bhutan faces a number of development challenges in achieving such growth given the limited resources. Moreover, addressing all the challenges at one point in time is found to be difficult and the results have not always been in line with the expectations as the experiences from the Washington Consensus show. This suggests that a more realistic and manageable approach for Bhutan will be to identify constraints that are most critical and address these constraints as noted in the Barcelona Consensus of 2004.¹ An approach prioritizing the constraints and targeting the most critical ones promises the largest development impact.

¹ Sixteen leading economists, Oliver Blanchard, Guillermo Calvo, Daniel Cohen, Stanley Fishcher, Jeffrey Frankel, Jordi Gali, Ricardo Hasumann, Paul Krugman, Deepak Nayyar, Jose-Antonio Ocampo, Dani Rodrik, Jeffrey Sachs, Joseph Stiglitz, Andres Velasco, Jamie Ventura, and John Williamson, gathered in Barcelona in September 2004 to discuss effects of

Figure 1: Inclusive Growth Concept



3. As part of the efforts in searching for new development strategies, several Harvard economists have pioneered the Growth Diagnostic Framework, which is a systematic methodology for undertaking a country diagnosis and identifying binding constraints to growth.² The approach of targeting the most binding constraints is based on a thorough and rigorous diagnosis of an economy. It has been widely adopted by multilateral and bilateral development partners and has been found to be a useful planning tool. Building on this, ADB has developed a framework for diagnosing constraints to inclusiveness of growth, which has been applied to Nepal and Indonesia. While the usefulness of these frameworks and their implementation is clear, their wider adoption, especially in smaller developing member countries (DMCs), is limited by the weak analytical capabilities of planning agencies, and Bhutan is no exception. The project aims to address this technical gap by introducing the diagnostic approach and jointly undertaking a diagnostic of constraints to inclusive growth for Bhutan with the government. The study will work closely with the key government agencies, including the Ministry of Finance, the Gross National Happiness Commission, and the National Statistical Bureau, so as to impart diagnostic skills to

economic reforms, lessons for future policy making, and performance of international economic systems, and issued a consensus on growth and development. A key recommendation of the Barcelona Consensus was that, since no single set of policies could guarantee growth, priority for developing countries searching for an effective development strategy should be to identify the most critical constraints to growth and remove them through appropriate microeconomic and macroeconomic policies.

² See Hausman, R., D. Rodrik, and A. Velasco. 2005. *Growth Diagnostic*. Cambridge. Harvard University.

the key staff of these agencies, which will help ensure the sustainability and institutionalization of the approach.

B. Impact and Outcome

4. The project is expected to enhance the development impact of Bhutan's own interventions and ADB's and other development partners' lending and nonlending operations in the country. The envisaged outcome is the enhanced capacity of the country in undertaking country/sector development diagnosis, identifying critical constraints to growth, and formulating development plans and poverty reduction strategies addressing them. The Design and Monitoring Framework is in Appendix 2.

C. Outputs and Activities.

5. The key outputs of the project will be (i) a diagnosis of critical constraints to development and policy options summarized in a report entitled Bhutan: Critical Development Constraints, and (ii) dissemination of the study findings (both in-country and regional).

6. The key activities are divided into four steps. The first step is a study tour, which aims to expose the Bhutanese government to the diagnostic approaches/techniques and their usefulness for the country's development planning. Key government officials from Bhutan will be invited to one of the countries in which ADB has conducted a diagnostic study. The second step will involve reviewing Bhutan's growth performance and poverty and inequality trends, analyzing key economic growth and poverty reduction drivers, and identifying candidate constraints to inclusive growth. The third step will involve formulating a set of hypotheses regarding critical constraints to growth and poverty reduction, and validating each hypothesis through evidence-based analysis and statistical testing. The fourth step will undertake in-depth studies on the identified critical constraints to analyze further the issues in the respective areas, and formulate possible remedial actions to address the critical constraints.

7. The project will adopt a consultation approach to the study and conduct a number of in-country workshops to elicit feedback on the study approach, the analyses, and the findings. Key stakeholders from the government, academic and research communities, civil society groups, business communities, development partners, and ADB staff will be invited to an inception as well as consultation workshops. The inception workshop will aim to expose key stakeholders to the diagnostic approaches and provide an opportunity for discussion on development challenges faced by Bhutan. Consultation workshops will be conducted to elicit feedback and disseminate the findings. The project will also conduct regional dissemination to share the experiences from the project on Bhutan and expose key government officials from other countries in South Asia to the diagnostic approaches to development planning.

D. Implementation Timeframe

8. The project will be implemented over a period of one year, from October 2010 to September 2011. The schedule for the implementation of the proposed activities is in Appendix 5.

E. Project Evaluation and Information Dissemination

9. The outcome of the project will be improvement in planning processes and its achievement will be evident from its adoption by the government in its planning processes. Key stakeholders will also be involved in various consultations and requested to provide feedback. Hence no separate evaluation study is needed. The project will conduct a number of in-country workshops to disseminate the findings of the study among government officials, academics, interested civil society groups, business

communities, development partners, and ADB staff. Regional dissemination will also be undertaken to share the experiences from the project on Bhutan with other countries in South Asia. In addition, the project will establish a website and mailing list for an even wider dissemination of the findings.

F. Scope of Replication/Use in other DMCs

10. Diagnostic technique is new to South Asia, and of particular importance to smaller countries such as Bangladesh, Maldives, and Sri Lanka³ among others. The project will conduct regional dissemination to expose key government officials from other South Asian countries to the diagnostic approaches to development planning.

G. Cost Estimates and Financing Plan

11. The total cost of the Project, estimated at \$275,000, will be financed through regional TA 6337 (Development Partnership Program for South Asia [DPPSA]), funded under the Australia-ADB South Asia Development Partnership Facility. The detailed cost estimate and financing plan are in Appendix 3.

H. Proposed Project Management System

12. The project will be implemented by ADB in consultation with the government of Bhutan and in partnership with relevant in-country academics/research institutions. ADB's Economics and Research Department (ERD) will administer the project in close coordination with the country team in the South Asia Regional Department (SARD). The project will establish a peer review group drawing membership from the government, academic and research communities, business communities, and development practitioners for exchange of ideas and feedback on the findings. The Performance Monitoring Report will be submitted on a quarterly basis.

13. The project will require an estimated 15 person-months of consulting services in macroeconomic and microeconomic analyses (7 person-months international and 8 person-months national). The consultants will be supported by a number of research assistants, to be engaged on an as-needed basis. Given the intermittent nature of assignments and anticipated variety of expertise required, all consultants will be engaged by ADB as individuals in accordance with its *Guidelines on the Use of Consultants* (2010, as amended from time to time). Outline terms of reference for the consultants are in Appendix 4. Disbursements under the TA will be made in accordance with ADB's *Technical Assistance Disbursement Handbook* (May 2010, as amended from time to time).

³ The country diagnostic study was conducted for Nepal by ADB's Economic and Research Department (ERD) through RETA 6397: Strengthening Country Diagnosis and Analysis of Binding Development Constraints in Selected Developing Member Countries. However, the intended focus was on the Nepalese audience and did not engage in other DMCs in South Asia.

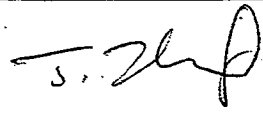
Appendixes

1. Design and Monitoring Framework
2. Cost Estimates and Financing Plan
3. Outline Terms of Reference
4. Details of Implementation Schedule
5. Disbursement Schedule

APPENDIX 1: DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
Impact Enhanced development impact of Bhutan's national development plan and ADB's and other development partners' operations in the country	<ul style="list-style-type: none"> • New five year plan adopts the diagnostic approach as a basis of strategy planning in some of key areas • Partnership strategies with some of key development partners are based on careful diagnosis of the economy 	<ul style="list-style-type: none"> • Five year plan • Country Partnership Strategy (ADB) • Country Assistance Strategy of development partners 	Assumptions <ul style="list-style-type: none"> • Willingness of policy makers to base their medium to long term policies on economic considerations
Outcome Enhanced capacity of government in undertaking country/sector diagnosis, identifying critical constraints to growth, and formulating development plans and poverty reduction strategies addressing them	<ul style="list-style-type: none"> • Awareness and recognition of diagnostic approaches to development planning • Visible improvements in analytical capacities in government and non-government agencies 	<ul style="list-style-type: none"> • Country operations business plans (ADB), TA pipeline, and government reports/studies 	Assumptions <ul style="list-style-type: none"> • Methodology developed under the TA effectively disseminated amongst stakeholders Risks <ul style="list-style-type: none"> • Weak capacities in key planning agencies within the government
Outputs 1. A diagnosis of critical constraints to development and policy options to address these 2. Dissemination of study findings	<ul style="list-style-type: none"> • Published Bhutan Critical Development Constraints • Dissemination workshops including media events 	<ul style="list-style-type: none"> • Published Report, TA Performance Report (TPR), and Project Information Document (PID) • Media coverage, TPR, and PID 	Assumptions <ul style="list-style-type: none"> • Access to high-quality national income accounts, labor force survey, household survey, and sector-specific data sets • Availability of institutions and individual experts with familiarity and knowledge of Bhutan economy
Activities with Milestones 1.1 Mobilization of the core team of experts (October 2010) 1.2 Formation of the peer review group (October 2010) 1.3 Establishment of a study website and mailing list (October-November 2010) 1.4 Conduct of a study tour (November 2010) 1.5 Conduct of an inception workshop to agree on the diagnostic methodology and framework (December 2010) 1.6 Conduct of growth inquiry and identification of constraints (January-March 2011) 1.7 Conduct of a consultation workshop to agree with stakeholders on initial findings (April 2011) 1.8 Conduct of in-depth studies on key constraints (April-June 2011) 1.9 Undertake a mini enterprise survey as needed (April-June 2011) 1.10 Identification and formulation of policy recommendations to address most critical constraints (July 2011) 1.11 Conduct of final consultation (August 2011) 1.12 Finalization of Report (September 2011)			Inputs ADB-administered financing (DPPSA Grant): \$275,000 7 person-months of international and 8 person-months of national consulting services

1.13 Printing of Report (September 2011)



JUTHONG ZHANG

Name and Signature
Assistant Chief Economist

APPENDIX 2: COST ESTIMATE AND FINANCING PLAN (\$'000)

Item	Total cost
A. Asian Development Bank Financing⁴	
1. Consultants	
a. Remuneration and Per Diem	
i. International Consultants	105,000
ii. National Consultants	32,000
iii. Research Assistants	24,000
b. International and Local Travel	10,000
c. Reports and Communications	5,000
2. Travel of Staff as Resource Persons	10,000
3. Study Tour	15,000
4. Training, Seminars, and Workshops	15,000
5. Data, Surveys, and In-depth Studies	25,000
6. Miscellaneous Administration and Support Costs	10,000
7. Contingencies	24,000
Total	275,000

Source: Asian Development Bank estimates.

⁴ Financed under RETA 6337: Development Partnership Program for South Asia, which is funded by the Government of Australia through the Australia-ADB South Asia Development Partnership Facility, and administered by ADB. Total amount also includes ADB's administration fee, audit cost, bank charges, and provision for foreign exchange fluctuations (if any), to the extent that these items are not covered by the interest and investment income earned on this grant, or any additional grant by the Government of Australia.

APPENDIX 3: OUTLINE TERMS OF REFERENCE

A. International Consulting Services

1. Lead Economist/Team Leader (2 person-months, intermittent)

1. The Specialist will lead the study and provide guidance to other international and national consultants. He/she should have a strong background in development economics and extensive work experience and understanding of diagnostic approaches. In leading the study, the specialist will:

- (i) assist ERD staff in preparing and updating periodic progress reports on the study,
- (ii) facilitate formation and functioning of peer groups drawing membership from national planning agencies, academic and research institutions, other development partners, and interested civil society organizations,
- (iii) review the pattern of growth exhibited by Bhutan and compare it with the experiences in similar regional and non-regional economies,
- (iv) decompose the economic growth taking into account factors of production, demand and supply side, and compare with the experiences in similar regional and non-regional economies,
- (v) undertake an overarching diagnostic analysis of constraints to a broad based economic growth, which would identify the topics for in-depth studies,
- (vi) consolidate findings of the constraint specific studies to identify the binding constraints and policy options to address these binding constraints into a draft final country diagnostic report,
- (vii) facilitate conduct of the in-country workshop and prepare a presentation summarizing the findings of the country diagnostic report in a workshop, and
- (viii) finalize the country diagnostic report by incorporating comments and feedback received at the in-country workshop.

2. Development Economists (4 person-months, intermittent)

2. The specialists will undertake 2-3 studies on key development issues such as: poverty and inequality, rebalancing and broadening growth, and environmental sustainability. The specialists should have a good understanding of issues in their respective areas and in development issues in South Asia. The specialist will:

- (i) review the trends in respective areas in Bhutan and compare these with the experiences in South Asia and in other economies,
- (ii) undertake a diagnostic analysis following a systematic framework to identify the major constraints in the area,
- (iii) summarize the findings of studies on the constraints and the policy options to address these in a report that will constitute a section of the overall country report,
- (iv) coordinate regularly with other colleagues on the evolving findings and provide feedback to ensure consistency and complementarity of final output, and
- (v) present findings of the report in the in-country workshop.

3. Economics Editor (1 person month, intermittent)

3. The specialist shall have extensive experience in editing economic publications. The specialist will be engaged to ensure high quality of publications. Under the supervision of ADB staff, the editor will:

- (i) review and edit the draft report and individual comments to ensure that edited materials adhere to ADB style and usage, conform to high publication standards, and are properly and timely delivered,
- (ii) oversee the typesetting of the report,
- (iii) oversee the publication of the report,
- (iv) assist in the development of the study website.

B. National Consulting Services

1. Country Economists (8 person-months, intermittent)

3. The specialists will undertake 3 to 4 in-depth studies on the critical constraints identified in the overarching analysis. The specialists should have a strong understanding of Bhutan's economy and should have a specialization in the relevant areas. In undertaking the constraint specific studies, the specialists will:

- (i) assemble the relevant country and cross-country data sets and identify the underlying factors responsible for the critical constraints,
- (ii) coordinate regularly with other colleagues on the evolving findings and provide feedback to ensure consistency and complementarity of final output,
- (iii) identify relevant policy recommendations for addressing the binding constraints,
- (iv) present findings of the constraint specific study to the peer group for review and feedback,
- (v) summarize findings of the constraint specific study in a report, which will constitute section/sections of the overall country report, and
- (vi) present findings of the report in the in-country workshop.

2. Research Assistants (as needed, intermittent)

4. A number of research assistants with background in economics or statistics with strong analytical skills will be engaged to support the country diagnostic study. Research assistants will:

- (i) assist in collection and analyses of study related data,
- (ii) assist in the updating of the TA reports, study website, and mailing list, and
- (iii) assist in the preparation of presentation and reports.

APPENDIX 5: DISBURSEMENT SCHEDULE

	Estimated Costs (in US \$)	Disbursement Timing
Consultants	176,000	Throughout the study.
Travel of Staff as Resource Persons	10,000	4th Quarter 2010, 2nd and 3rd Quarter 2011.
Training, Seminars, and Workshops	15,000	4th Quarter 2010, 2nd and 3rd Quarter 2011.
Data, Surveys, and In-Depth Studies	25,000	As needed.
Study Tour	15,000	4th Quarter 2010.
Miscellaneous Administration and Support Cost	10,000	Through out the study.
Contingencies	24,000	As needed.

Note: Consultant costs include remuneration, international travel and per diem, and report and communication costs.