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EUROPEAN EXTERNAL ACTION SERVICE



EUROPEAN COMMISSION - DIRECTORATE GENERAL FOR
DEVELOPMENT AND COOPERATION - EUROPEAID

MULTIANNUAL INDICATIVE PROGRAMME (MIP) 2014-2020

BHUTAN

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BHUTAN

Abbreviations

ADB	Asian Development Bank
BS	Budget Support
BTN	Bhutan Ngultrum
CSO	Civil Society Organisation
CSP	Country Strategy Paper
ECP	Environment, Climate Change and Poverty
EIB	European Development Bank
EU	European Union
PFM	Public Finance Management
FAO	Food and Agriculture Organisation of the UN
FYP	Five Year Plan
GDP	Gross Domestic Product
GECDP	Gender, Environment, Climate change, Disaster risk reduction and Poverty
GEF	Global Environment Fund
GLOF	Glacial Lake Outburst Floods
GNH	Gross National Happiness
GNHC	Gross National Happiness Commission
GNI	Gross National Income
ICT	Information and Communication Technology
IDA	International Development Association
IFAD	International Fund for Agriculture Development
IFC	International Finance Cooperation
JSP	Joint Support Programme
KRA	Key Result Area
LGSP	Local Government Support Programme
LGSDP	Local Governance Sustainable Development Programme
MDG	Millennium Development Goal
MIP	Multi-annual Indicative Programme
MoF	Ministry of Finance
MoAF	Ministry of Agriculture and Forestry
MoU	Memorandum of Understanding
PBGs	Performance Based Grants
PEI	Poverty Environment Initiative
PFM	Public Finance Management
RAA	Royal Audit Authority
RNR	Renewable Natural Resources
RNRSP	Renewable Natural Resources Sector Programme
Rs	Rupees
SKRA	Sector Key Result Areas
SME	Small and medium-sized enterprise
UN	United Nations
USD	US Dollar
WB	World Bank
WTO	World Trade Organisation
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme

1. The overall lines for the EU response

1.1 Strategic objectives of the EU's relationship with the partner country

Bhutan (a 733 000 inhabitants landlocked country between India and China) embarked only recently upon a peaceful modernization and democratization process from an absolute to a constitutional monarchy. In 2008, the first national assembly elections were organized and the Constitution was adopted. In 2013, the opposition won the second National Assembly elections and the country went through a peaceful transfer of power. In parallel, Bhutan has defined its vision for 2020 based on: peace, prosperity and happiness. The development planning in Bhutan is based on a 5 year cycle. The first Five Year Plan (FYP) started in 1961 and Bhutan is currently implementing its 11th FYP. The overall development objective for the 11th FYP is to achieve self-reliance and inclusive green socio-economic development. Key priorities of the 11th FYP are deepening the decentralization process, addressing increased rural to urban migration, fighting youth unemployment, diversification of the economy and the exports, as well as access to finance for small and medium enterprises (SMEs). Despite a negligible contribution to greenhouse gas emissions, Bhutan is highly vulnerable to natural disasters and climate change. Progress towards a carbon neutral economy through green growth initiative is also an emerging priority of the Royal Government of Bhutan.

The world's 'youngest democracy' is still facing some political challenges, related to limited capacities of the new political institutions at central level, an unfinished decentralisation process and a still weak civil society. The issue of people in the refugee camps in Nepal is still not entirely solved and remains a matter of concern to the country's partners. Bhutan maintains close and friendly relations with all its development partners, especially India, its single largest trading and development partner. Bhutan does not have diplomatic relations with China, the only other country apart from India with which it shares borders; its relations with China are nonetheless friendly and official level visits are exchanged on an annual basis.

The modernization process has led to positive results not only in terms of political stability, but also economic growth and accelerated progress towards MDG targets. Annual average growth had been 8.2% in the period 2008–2012 and is estimated at 8% for 2013-2014. Per capita gross national income (GNI) has consistently risen from USD 730 in 2000 to USD 2 420 in 2012. Poverty has been reduced by half (23.25% in 2007, 12% in 2012). Economic growth in Bhutan is mainly driven by hydropower development (about 35% of government revenue) and donor support (about a third of the national budget). Bhutan depends on trade with India, which absorbs 95% of Bhutan's exports and supplies 75% of its imports. The strong economic growth has enabled the government to support poverty reduction initiatives and advance social development. However, big gaps remain in terms of development between urban and rural areas, the Asian Development Bank (ADB) estimating that about 97% of Bhutan's poor live in rural areas. Thus, agriculture remains the main source of income for the majority of the population.

The main strategic objective of EU-Bhutan cooperation is to support Bhutan's democratisation and modernisation process. The EU will support the Royal Government of Bhutan's development agenda and efforts to reduce poverty through inclusive socio-economic development and growth and also to strengthen democratic governance mechanisms and reforms. Moreover, climate change will remain an important part of the EU cooperation with Bhutan, with particular attention to tackling climate impacts on sustainable development. EU-Bhutan cooperation is therefore expected to contribute to a more stable Bhutan and a more prosperous South Asia.

1.2. Choice of sectors

EU's assistance to the Royal Government of Bhutan will support the implementation of the 11th FYP from July 2013 to June 2018. The FYP's overall goal is 'Self-Reliance and Inclusive Green Socio-Economic Development'. The National, Sectoral and Local government Key Result Areas (KRA) have all been prepared in accordance with the four pillars of the Gross National Happiness (GNH) viz. 1) Equitable and Sustainable Socio Economic Development; 2) Preservation of Environment; 3) Preservation and Promotion of Bhutanese Culture; and 4) Strengthening Good Governance. Five strategies will be used to achieve the KRAs, namely poverty reduction, private sector development, human resources development, balanced regional development, and improving Information, Communication, Technology and Media (ICT). Gender, Environment, Climate change, Disaster risk reduction and Poverty (GECDP) are defined as the FYP's cross-cutting issues.

The assistance needs for the Royal Government of Bhutan in relation to the implementation of the 11th FYP remain high. The main development partners for Bhutan are India, WB¹, ADB², IFAD, FAO, UN agencies, Japan, Switzerland, Norway, EU and EU Member States (Denmark, Austria, and the Netherlands). India remains the largest bilateral development partner, with an Assistance Package of INR 45 billion grant and INR 5 billion for Economic Stimulus plan (more than EUR 565 million) in support of the 11th FYP. Denmark is phasing out its bilateral assistance in 2015 and Switzerland in 2016.

The EU's Country Strategy for Bhutan 2007-2013 focused on three main areas: Renewable Natural Resources (RNR), Good Governance, and Trade and Economic Capacity Building, with a financial envelope of EUR 14 million. EU support for trade and economic capacities ended in 2009 and helped to facilitate Bhutan's full and effective participation in the WTO. The support for good governance ended in 2013, while budget support and technical assistance programmes for the Renewable Natural Resources (RNR) sector are continuing.

Bhutan is eligible for EU thematic and regional programmes. It has benefitted from the Global Climate Change Alliance (with a focus on climate change mainstreaming into the RNR sector), Erasmus Mundus (the Royal University of Bhutan has been participating in the Erasmus External Cooperation Window-Asia since 2006), SWITCH Asia programme (grant programme dealing with trade and sustainability), Rural Livelihoods and Climate Change Adaptation in the Himalaya (a five year programme focused on climate change adaptation in eight Himalayan countries), as well as health thematic programmes (dealing with avian flu health issues).

The European Investment Bank (EIB) is planning to establish a Framework Agreement with Bhutan to launch investments in three sectors: (1) renewable energy and climate change mitigation/adaptation; (2) water/sanitation and other municipal infrastructures (economic infrastructure); and 3) SME support (local private sector development).

Building on past experience and in order to maximise impact and contribution to development outcomes, the EU and the Gross National Happiness Commission (GNHC) agreed to focus EU's assistance for 2014-2020 on two sectors: 1) good governance (Pillar 4 of the GNH) and 2) renewable natural resources, while addressing FYP's cross cutting issues in EU-funded programmes and projects. Sector Budget Support (BS) will be used as the preferred aid delivery method where appropriate. Bhutan has been assessed positively with regard to the fulfilment of EU BS eligibility criteria (a

¹ The current WB-Bhutan Country Partnership Strategy (CPS) covering FY 2011–14 is in line with Bhutan's 10th Five Year Plan and was prepared jointly with the International Development Association (IDA) and the International Finance Corporation (IFC).

² ADB support to Bhutan to focus on transport, energy/hydropower and urban development.

stability-oriented macroeconomic policy, progress in Public Finance Management (PFM) systems, transparency of the budget and appropriate sector policies for the chosen sectors).

Sector 1: Local authorities and civil society

EU support to 11th FYP's objectives in the area of good governance³ (4th pillar) will focus on three areas:

a) Fiscal decentralization and capacity development for local governments

The Local Government Act 2009 and the first local elections after the adoption of the constitution in 2011 furthered the processes of devolution of power and resources to the local governments (at district - *dzongkhag* and sub-district – *gewog* level). To bring clarity on the roles of various levels of the government a division of responsibilities framework⁴ was developed in 2012 which delineates responsibilities among the central agencies, the *dzongkhags* (districts) and the *gewogs* (sub-districts), guided by the principle of subsidiarity. The next local government elections are scheduled to be held in 2016.

The Royal Government of Bhutan and a group of development partners (Denmark, Austria, Netherlands, UN Development Programme, United Nations Capital Development Fund and Switzerland) signed a Memorandum of Understanding (MoU) on the 'Partnership for Good Governance' 2008-2013. It defines a five-year Local Governance Support Programme (LGSP) with a total budget of USD 17.58 million. The project is implemented by the Department of Local Governance under the Ministry of Home and Cultural Affairs focusing on fiscal decentralization, capacity development and financial management of the local government and integrated public service delivery. Government of India's support to local government was through the Small Development Projects (budget of INR 7 billion/EUR 83 million, around 1800 projects for the 10th FYP) and the same was rendered to the local governments as the capital grants.

The EU became signatory to the 'Partnership for Good Governance' in 2011 and then started funding the LGSP, with EUR 2.8 million to support the Royal Government of Bhutan's Annual Capital Grant facility, to ensure budgetary transfers from central to local level. LGSP was evaluated in 2013 at the initiative of the Gross National Happiness Commission as a ground-breaking flagship project supporting local governance through innovative practices for financial decentralization, local capacity development and service delivery. The evaluation recommended the extension of the program. Denmark, Switzerland, UNDP/UNEP and UNCDF will support a new phase: the Local Governance and Sustainable Development Programme (LGSDP). It integrates the 'Poverty Environment Initiative' (PEI). It will mainstream environment, climate change, disaster, poverty and gender in local governance.

The government highlighted decentralisation towards *gewog* level as their priority under the 11th FYP with the ambition to ensure more substantial transfers from central to local budgets (about BTN 20 billion/EUR 236 million in the 11th FYP). The recommendation of the EU Election Expert Mission of July 2013 as well as the comments of the Election Commission of Bhutan thereon would also need to be taken into account in order to contribute to the improvement of the electoral process in the country. Local institutions and personnel capacities are central to sustainable development. Capacity building allows people, organisations and society as a whole to manage their affairs successfully. EU support to capacity development will be fully aligned with the priorities in the 11th FYP.

³ European Commission's Communication COM(2013) 280 final of 15.5.2013 "Empowering Local Authorities in partner countries for enhanced governance and more effective development outcomes" points out the importance of Local Authorities in partner countries to achieve sustainable development and equitable outcomes and to create the conditions for inclusive, responsive and effective development processes.

⁴ See <http://www.gnhc.gov.bt/guidelines-local-government/>

Taking into consideration the strong government - donor coordination, government's ownership, previous EU engagement and the alignment with Royal Government of Bhutan's development priorities, the EU is planning to continue supporting the sector by contributing along with other development partners to LGSDP which is part of the 11th FYP.

b) Capacity development for civil society

Civil Society Organisations (CSOs) have only emerged since 2008. Their ability to voice people's opinions and influence policy making is still at a very early stage and there is a clear need for a more structured dialogue with CSOs in the public policy processes along the lines developed in the European Commission's Communication⁵ of 12 September 2012 related to Europe's engagement with Civil Society in external relations. Bhutan passed the CSO Act in 2009 and established the CSO Authority in 2010, a governmental body which registers CSOs and ensures communication and liaison between CSOs and state institutions. As of April 2013, about 31 CSOs were registered with the CSO Authority.

Development partners such as Denmark, Austria, Netherlands and Switzerland have contributed since 2010 to the CSO Funds Facility, a temporary mechanism aimed to enable non-state actors (media, civil society and private sector) to contribute to Bhutan's democratisation and modernisation. In coordination with other development partners, EU assistance will support this mechanism, as there is still a need for further strengthening the civil society through projects, capacity development for management and organisation, and also by supporting dialogue between CSOs and public institutions at central and local levels.

c) Public Finance Management reform

EU assistance will also support PFM reform as an additional measure required to continue using budget support as well as to promote good governance and facilitate fiscal decentralisation. Current EU-Bhutan policy dialogue on PFM and assessment of reforms in the framework of the budget support operations showed that technical assistance is needed on procurement system, tax regulations and tax payer registration and fiscal decentralisation. World Bank (WB) supported an assessment of the PFM system, identified key areas for improvement and the Royal Government of Bhutan prepared an action plan prioritizing PFM reform measures, including predictability and control in budget execution, and improved accounting recording and reporting. Discussions with World Bank are on-going on the establishment of a multi-donor good governance group for PFM. In addition, PFM reform will also aim at improving and strengthening the management of macro-economic issues, strengthening the strategic planning and results based management capacity and strengthening monitoring and evaluation capacities of the government agencies.

Sector 2: Sustainable agriculture and forestry

The Renewable Natural Resources (RNR) sector takes a prominent role in the Royal Government of Bhutan 11th FYP, as it contributes to all the four pillars of GNH (in particular pillars 1 – equitable and sustainable socio-economic development, and 3 - preservation of the environment). Even if agriculture's contribution to GDP declined by half in 30 years (16% of GDP in 2012, 35% in 1990), the sector registered recently higher annual growth rate (3.44% in 2012, compared to 2% during 2004-2008). Due to limited areas of land available for agriculture (about 2.9% of the land is used for agriculture and about 70.5% of the land area is covered by forests), Bhutan faces food security issues and is dependent on food imports from India. On the other hand, accelerated deforestation is

⁵ COM(2012) 492 final of 12.9.2012 "The roots of democracy and sustainable development: Europe's engagement with Civil Society in external relations"

threatening the sustainability of Royal Government of Bhutan's policies. RNR is at the centre of the Bhutan's development strategy, due to its potential to enhance food and nutrition security, reduce poverty, generate export earnings in Indian Rupees and substitute for food imports.

The EU is a major player in the RNR sector in Bhutan. Other development partners involved are the International Fund for Agriculture Development (IFAD), Japan, India, Global Environment Fund (GEF), World Bank (WB), and others. The level of external assistance is quite high, the sector receiving more than 70% of its capital investment from development partners. With EU support, the Ministry of Agriculture and Forests has made steps to improve coordination through annual donor-government meetings.

EU support to RNR has represented the backbone of EU-Bhutan cooperation since the early 1980s, based upon sustained excellent relations with the Ministry of Agriculture and Forestry. The EU is currently implementing under CSP 2007-2013 a RNR budget support programme of EUR 6.6 million for the period 2011-2014 and a Technical Cooperation Project for building capacity of the Ministry of Agriculture and Forestry (EUR 4.6 million, 2014-2017). Under the Global Climate Change Alliance, a EUR 4.4 million programme aims at enhancing climate change resilience of Bhutan's rural households.

The EU will continue supporting the RNR sector to consolidate the results achieved through the current programmes as well as to achieve the 11th FYP's objectives in the sector: enhancing food and nutrition security, improving rural livelihood and generating employment, accelerating sector growth through commercial farming and enterprises and promoting sustainable use of natural resources. EU interventions in the RNR sector will be accompanied by capacity development for institutions and personnel to ensure sustainable development of the sector. Working conditions and compliance with international labour standards will also be addressed.

At the same time, it may be envisaged to support inter-sectoral coherence between the RNR sector and other sectors that have an impact on natural resource management, such as tourism, roads, transport etc., and reflecting Bhutan's approach of inclusive green socio-economic development. Attention will be paid also to reducing regional development disparities, as well as addressing rural-urban migration, which has been increasing recently. EU assistance will continue to address climate change impacts on Bhutan's population, economy and natural resources, of which Glacial Lake Outburst Floods, (GLOF) are a constant threat, given the accelerating melting of glaciers. Where relevant, EU support will be provided with the involvement and consultation of local authorities and civil society.

2. Financial overview (indicative amounts)

<u>Local authorities and civil society</u>	EUR 24.0 million	57.2 % of MIP
– <i>Fiscal decentralization and capacity development for local authorities</i>	EUR 17 million	
– <i>Capacity development for civil society</i>	EUR 4.0 million	
– <i>Public Finance Management reform</i>	EUR 3.0 million	
<u>Sustainable Agriculture and Forestry</u>	EUR 16.5 million	39.3 % of MIP
- <i>Support to RNR 11th FYP</i>	EUR 16.5 million	
<u>Support measures</u>	EUR 1.5 million	3.5 % of MIP
– <i>Identification, Formulation, Other ad hoc Studies, Outreach and visibility actions</i>	EUR 1.5 million	
<u>Total</u>	EUR 42.0 million	

3. EU support per sector

3.1 Local authorities and civil society/ indicative amount: EUR 24 million

3.1.1 Overall and specific objectives

The overall objective of EU support in this area is to consolidate the modernization and democratization process of Bhutan. EU support will have three specific objectives:

- a) To empower local authorities;
- b) To develop civil society structures and capacities;
- c) To improve public finance management at central and local level.

3.1.2. Expected results for the specific objectives

a) *To empower local authorities*

a.1) Functioning of the Annual Capital Grant (AGC) system to local governments improved in mechanism and modalities for fiscal decentralisation

- Sufficient financial resources (investment, functioning and capacity development) are effectively and regularly transferred to *dzongkhags* and *gewogs* from the state budget and the Annual Capital Grant Facility
- Own financial revenues mobilised by *dzongkhags* and *gewogs* are increased
- Average of AGC disbursements per *gewog* and per year
- Level of utilization and performance of AGC in terms of GECDP mainstreaming, good governance and accountability

a.2) *The Capacity Development Strategy for Local Governance is revised and fully implemented-*

- - Training of local administrative officers and accountants in planning and monitoring systems (PLAMS), as well as in public expenditure management systems (PEMS)
- Adequate services are effectively delivered to the population by *dzongkhags* and *gewogs*

a.3) *Public participation, transparency and accountability of local governments is improved*

- Annual plans, budget and expenditure are prepared on time, made available to the public and the Royal Audit Authority (RAA) by *dzongkhags* and *gewogs*
- Number of elected women in local governments increased

a.4) Gender, Environment, Climate Change, Disaster and Poverty are better mainstreamed into local development planning

- improvement of data, information and knowledge related to green economic development , linked to the National Statistics Bureau, provided by the *gewogs*
- number of proposals on green economic development implemented at local level
- number of employment opportunities created

b) *To develop civil society structures and capacities*

b.1) set-up of a well-functioning call for proposal mechanism

- Sufficient financial resources for project implementation and capacity development are made available to CSOs (Civil Society Organisations)
- Creation of a CSO Fund Facility Unit
- Establishment of a project Steering Committee

b.2) Capacities of CSOs in management and project implementation are enhanced

- training of CSOs employees and workers in managerial and technical skills
- Significant development outcomes are delivered by CSO through project implementation

- CSOs are well managed (financial, organisation) and able to meaningfully contribute to policy dialogue and consultations as well as enabling them to participate in Environmental Impact Assessment of major developments
- b.3) Establishment of a mechanism for policy consultation between CSOs and Government
- CSOs are regularly consulted and their input is integrated in public institutions' policy making processes
 - Role of CSO Authority is strengthened
- c) *To improve public finance management (PFM) at central and local level*
- c.1) *Establishment of a PFM Good Governance Group*
- Budget preparation and execution are improved
 - PFM Good Governance Group is established and functioning to better coordinate the reform process, tax regulations and tax payer
 - Internal and external control mechanisms function efficiently and effectively
 - PEFA or similar scores are satisfactory
- c.2) *Strengthening of the public procurement system*
- Procurement processes effectively implemented and deliver value for money
 - Procurement manual available and operational
 - Reduction of the number of audit observations by Central Government Audit Authority
 - New sources of local revenue generation have been identified and established

3.1.3. Main indicators for the specific results

In the future programme the focus will be on outcome indicators in order to move towards impact assessment. The main indicators for measuring the aforementioned results are contained in the sector intervention framework attached in Attachment 1.

3.1.4. Donor coordination and policy dialogue

In Bhutan the governance sector is the only sector in which a substantial level of donor coordination has been established since 2008 and has continuously been strengthened. The main other partners supporting the governance sector and decentralisation in particular are Denmark (phasing out by 2015) and Austria, UNDP, UNCDF and Switzerland. Parallel funding has in the past been provided also by Japan (JICA) and Helvetas. The Royal Government of Bhutan with support of interested donors has recently formulated the *Local Governance Sustainable Development Programme (LGSDP)*, which is a follow up programme of the Local Governance Support Programme and merges the former Local Governance Support Programme (LGSP) and the Joint Support Programme (JSP). Current donor commitments to fund the LGSDP includes DKK 32.0 million from Denmark (already committed under the Danish Transition Programme), and CHF 1.0 million from Switzerland. USD 1.5 million is expected to come from UNDP and USD 230,000 from UNDCF. The indicative EU contribution of EUR 17 million will make the EU the largest donor to this programme (budget support modality is envisaged).

In the past the policy dialogue on strengthening local governance was led by Denmark and UN agencies. The main forum for policy dialogue was the Programme Steering Committee meeting held very regularly twice a year, which brought all partners around the table and turned into a platform for all to address aspects related to the decentralisation process. Further dialogue was carried out through thematic working groups and the Joint Annual Review Mission and Joint Annual Review Meeting. It is envisaged that the LGSDP, conceived as the follow up of the Local Governance Support Programme, will adopt a similar approach. Importance has been given in the formulation phase to highlight the need to further harmonise donor support to the sector under the LGSDP.

The past CSO Programme also saw a high level of donor coordination and joint policy dialogue. Since 2008 Denmark, Helvetas and SNV Netherlands and more recently also Austria provided support jointly to the establishment of the Royal Government of Bhutan's Civil Society Organisations Authority and the registration of CSO, as well as the operation of the CSO Fund Facility to enhance capacities and implementation of activities of the CSO. Based on experience from this first CSO support project in Bhutan, the partners have recently agreed to fund the 'Joint Support Programme to Civil Society', which runs from 2011 to 2014 and is now funded by Denmark, Helvetas/Swiss Intercooperation, SNV and Austria. The programme has been designed to allow for additional development partners to join in and shows a high level of donor harmonisation. Austria intends to continue its support to the civil society beyond 2014 from 2015 to 2018. Cooperation with Austria will be considered in this area of support.

Donor coordination in the field of PFM is so far limited. However, the recent PFM reform programme as agreed between Ministry of Finance and the World Bank provides a good basis for a concerted support to PFM reforms and the planned establishment of a PFM Good Governance Group is expected to help increase donor harmonisation and a joint policy dialogue. As part of PFM, additional activities aimed at strengthening the management of macro-economic situation, enhancing the results based planning and improving the monitoring and evaluation capacities will be considered. The World Bank is already funding selected elements of the reform programme and has entered into discussions with the EU and other partners to assess options for creating a PFM multi-donor trust fund. An EU contribution to the multi-trust fund will be considered.

As the EU will become the main donor in the governance sector, funds allocated will have to include activities to cater for governance related workshops and activities. This will allow the EU to support on an ad hoc basis activities related to policy dialogue. The EU will be able to liaise with and financially support actions led by other donors, such as the UN agencies and Member States, in the field of governance.

3.1.5. The Government's financial and policy commitments

Good governance, including local governance and civil society development, is a cross-cutting aspect under the 11th FYP. Given the democratisation progress in Bhutan since 2008 and the recent successful first re-election of the National Assembly, there is no reason to doubt the commitment of the Government to deepening the democratization process in Bhutan. The 11th FYP foresees a continuation and strengthening of fiscal decentralisation to the Local Governments. Administrative empowerment of the Local Governments also ranks high in the list of priorities with regard to democratisation.

The newly elected Government has slightly adjusted the 11th FYP to increase its focus on fiscal decentralisation and empowerment of Local Authorities. It foresees a total allocation of BTN 15 billion – EUR 177 million) to be provided in form of formula-based annual capital grants to districts and *gewogs*. The new formula continues to consider the poverty level, the geographical size of the *gewog* and the population size, but it also includes additionally to the formula used under the 10th FYP, a multidimensional poverty index as well as the transport cost index for each individual district or *gewog*. Additionally, the Government foresees a yearly grant of a lump sum of BTN 2 million (EUR 23,600) to each *gewog* under the new 'Local Government Empowerment Programme', which amounts to a total allocation of BTN 5 billion (EUR 59 million) during the 11th FYP. Consequently, the total allocation to districts and *gewogs* is BTN 20 billion (EUR 236 million).

The Government is strongly concerned about the capacities of the elected local governments and therefore values capacity building efforts very highly. It is aware that a specific need for training and capacity building will emerge following the renewed local government elections of 2016, as many 'first time' local leaders are likely to be elected. Donor support is therefore particularly important in

2016 and 2017 to cover not only the cost to continue the annual capital grant system, but to ensure substantive trainings in all *gewogs* and districts as well.

3.1.6. The overall risk assessment of the sector intervention

The political risk to successful support to the Government in its transition to democratic governance is considered minimal as the process has been very smooth so far and is not expected to deteriorate. The Government continues to be highly committed on its path towards democracy, which is clearly proven by the successfully held 2013 elections with the smooth change of government and most other recent developments such as the local government elections in 2011 with by-elections in 2012, the agreement on the implementation of the LGSDP between Royal Government of Bhutan and various donor partners and the recent renewal of the support programme in the area of civil society strengthening.

3.2 Sustainable Agriculture and Forests / indicative Amount: EUR 16.5 million

3.2.1 Overall and specific objectives

The overall objective of EU support to the field of Sustainable Agriculture and Forests is to reduce poverty, develop sustainable rural livelihoods resilient to climate change impacts and reduce regional disparities by facilitating the achievement of the key objectives of the 11th FYP of the Royal Government of Bhutan for the Renewable Natural Resources Sector.

EU support will have two specific objectives :

a) to provide fiscal space to the sector budget to allow the Government to address selected Sector Key Result Areas (SKRA) as defined under the sector reform programme, in the following priority areas defined in the RNR 11th FYP: 1) Enhance food and nutrition security, 2) improve sustainable rural livelihoods and generate employment opportunities, 3) accelerate and sustain RNR sector growth and 4) promote sustainable management and utilization of natural resources.

b) to support innovative actions undertaken by Royal Government of Bhutan to enhance resilience to climate change and increase energy efficiency.

3.2.2. Expected results for the specific objectives

Envisaged results to be achieved under the programme cover the following :

a.1) To enhance food and nutrition security

- enhanced productivity and increased production of cereals, paddy, milk, eggs and vegetables

a.2) To improve sustainable rural livelihoods and generate employment opportunities

- enhanced employment opportunities and income for rural communities

- increased commercialisation and agricultural marketing

a.3) To accelerate and sustain RNR sector growth

- improved agriculture infrastructure

a.4) To promote sustainable management and utilization of natural resources

- increased use of climate smart agriculture

- enhanced forest management and preservation of the ecological integrity of forests

- enhanced biodiversity conservation

- ensured water security and ecosystems services

b.1) To support innovative actions to enhance resilience to climate change

- establishment of adequate institutional arrangements towards disaster risk reduction and enhancing resilience to climate change.

- Disaster resilience, preparedness and responsiveness strengthened

- b.2) To support innovative actions to increase energy efficiency
- meaningful and purposeful alternate renewable energy is promoted
- energy security enhanced

3.2.3. Main indicators for the specific results

In the future programme the focus will be on outcome indicators in order to move towards impact assessment. The main indicators for measuring the aforementioned results are contained in the sector intervention framework attached in Attachment 1.

3.2.4. Donor coordination and policy dialogue

Government-led donor coordination in the RNR sector has been assessed as rather limited in 2010, when the sector's eligibility for budget support was assessed for the first time. The number of donors supporting the sector is large as compared to many other sectors in Bhutan. However, external sector assistance is split in many small donor funded projects supporting specific elements of the sector reform programme in selected geographical areas. The EU-funded Renewable Natural Resources Sector Programme (RNRSP), which started implementation in 2011, therefore includes a specific focus on improving sector coordination and encouraging policy dialogue, with a view to increasingly harmonise donor support to the sector. Meanwhile, donor coordination and policy dialogue could be substantively strengthened under the RNRSP. In March 2013 a first Government-led coordination meeting was held, to which all partners supporting the sector were invited and attended in large numbers. The Ministry of Agriculture and Forestry expressed its intention to move towards one single Government-led multi-donor supported sector programme, on the basis of the sector FYP, which should replace the project-wise approach in the Ministry.

As an important donor to the sector the EU is well-placed to take the lead in further strengthening overall policy dialogue and encouraging other partners to join the EU in its support to the sector reform programme rather than funding independent projects and thereby increasing the level of donor harmonisation and alignment with the national sector reform programme. Initial talks were held with the World Bank, which is another major donor to the sector and has recently developed a budget support approach.

3.2.5. The Government's financial and policy commitments

Out of a total of BTN 213 billion (EUR 2,530 million) of the 11th FYP, BTN 13.7 billion (EUR 162 million – 6,4 %) will be allocated to the Ministry of Agriculture and Forest.

The overall theme of the 11th FYP of the Royal Government of Bhutan is the achievement of self-reliance through inclusive green socio-economic development, where 'self-reliance' means being able to increasingly meet socio-economic development expenditure through domestic revenue, 'inclusive' means reducing inequality by enhancing the standard of living and the quality of life especially for the vulnerable sections of the society, and 'green' means carbon neutral development. Under its 11th FYP the Royal Government of Bhutan commits itself to an environmentally friendly approach to development, which is clearly incorporated into the RNR sector reform programme. Climate change mitigation and adaptation also takes a prominent role in the 11th FYP. The RNR sector, with support of the Global Climate Change Alliance Programme funded by the EU, has incorporated important objectives related to the implementation of climate change adaptation measures under its specific objective of achieving climate change resilient agricultural development using climate smart agricultural practices.

The underlying concept of the 11th FYP is good governance. The Royal Government of Bhutan continues to be committed to strengthen its move towards democratic governance. As such,

governance is also formulated as an overarching approach within the RNR sector reform programme. Concerns regarding gender equality are reflected as crosscutting theme in the 11th FYP and continue to play an important role. However, it is envisaged to increase the role of gender aspects in the EU policy dialogue also at the sector level, including the RNR sector policy dialogue.

3.2.6. Environmental assessment

All interventions under this focal sector will be subject to environmental and climate screenings to determine the need for strategic environmental assessment, environmental impacts assessment and/or climate risks assessment. The application of the screening questionnaires based on the applicable EU guidelines (<http://capacity-4dev.ec.europa.eu/public-environment-climate/documents>) will help to determine need for and scope and detail of any required assessment and will identify opportunities to address in any specific environmental and climate change concerns in the project/programme formulation even if such assessment will not be needed.

3.2.7. Overall risk assessment of the sector intervention

Overall risks for EU assistance in the RNR sector are considered very low. The EU has a longstanding and very successful history of cooperation with the MoAF and is considered a valuable and reliable partner in the sector by the Royal Government of Bhutan.

There is however a certain risk related to the continued fragmentation of donor support to the sector, as this might result in overlapping of projects and programmes and additional burden on the Government with regard to reporting and monitoring requirements. The EU will therefore focus on further improving Government-led donor coordination under the RNRSP funded under the CSP 2007-2013 and work towards attracting other donors to join the EU's approach under a sector reform contract. Given the substantial financial contribution to the sector and the excellent relations with the Government and specifically the Ministry of Agriculture and Forestry, continued policy dialogue will help to increase donor harmonisation and alignment, increasing the use of country systems.

A considerable risk to the successful implementation of the RNR 11th FYP is the high level of vulnerability of the country and particularly its rural livelihoods and food production, to the effects of climate change. EU support therefore specifically includes a focus on climate smart agriculture and disaster risk management, as well as forest management.

Since the EU will continue to play a major role as a development partner in the sector, funds allocated will include activities to cater for sector related workshops and activities. This will allow the EU to support on an ad hoc basis activities related to policy dialogue. The EU will be able to liaise with and financially support actions led by other development partners, such as the World Bank in the field of sustainable agriculture/forests.

4. Support measures / indicative Amount: EUR 1.5 million

An indicative **amount** of EUR 1.5 million will be set aside for measures aimed at supporting the preparation and implementation of actions under the MIP including through feasibility studies, consultation and planning workshops, outreach, audits, evaluations and other activities as necessary to ensure a high quality design and implementation of actions.

Attachments

1. Sector intervention framework and performance indicators
2. Indicative timetable for commitment of funds
3. Country at a glance
4. Donor matrix showing the indicative allocations per sector