

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB1514

Project Name	Urban Development II
Region	SOUTH ASIA
Sector	Urban Development (100%)
Project ID	P090157
Borrower(s)	ROYAL GOVERNMENT OF BHUTAN
Implementing Agency	Ministry of Works and Human Settlement Thimphu City Corporation Phuentsholing City Corporation
Environment Category	<input type="checkbox"/> A <input checked="" type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
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1. Country and Sector Background

1.1 Bhutan is a small landlocked country in South Asia, located in the eastern Himalayas between emerging economic giants of the world, India and China. Bhutan is home to a population of about 672,000¹ spread over an area of 38,500 square kilometers with about 70 percent of land under forest cover. In the past couple of decades, Bhutan has experienced rapid social and economic growth as a result of prudent macroeconomic management, beneficial exploitation of hydropower resources and support from development partners. Also the country has seen significant political changes and transitions in recent years. Bhutan's political system has evolved from an absolute monarchy into a constitutional monarchy, following a decade of planning and consultations.

1.2 The social and economic transition is fueling rapid urbanization. Since 2000, the urban population in Bhutan is estimated to have grown by about 4.7 percent per year. Starting from a low base, the urban population now accounts for about a third of total population, and is expected to reach 50 percent by 2020. Rapid urban growth is generating a host of major challenges for this mountainous country of scattered small settlements. Meeting the challenges of urban development, management and finance has become a key developmental agenda for the Royal Government of Bhutan (RGOB) and its development partners.

1.3 Thimphu, the country's capital and by far the biggest city with about 80,000 residents, provides the largest stage for the new urban challenges. The city was growing rapidly at the pace of 7 to 10 percent during the decade up to 2005 and to accommodate this growth, the city area was expanded towards both south and north in 1997 and 2002. Thimphu City Corporation (TCC) was established in 1995. The nation's first comprehensive Structural Plan was prepared in 2002 for the greater Thimphu region. While the Structural Plan provides a good long-term framework,

¹ The first full census of 2005 revealed a population of 672,425 in Bhutan.

and TCC provides services competently with adequate cost recovery in core areas (particularly for water and sewerage services), the city has been struggling to manage urban expansion, and newly extended areas in the north and south of Thimphu remain underdeveloped and lack basic urban infrastructure.

1.4 In order to avoid legal and financial burdens of land acquisition for providing public infrastructure, the Royal Government has adopted an area development strategy through land pooling. This requires land owners to contribute approximately 25 percent of their land in exchange for internal roads, drainage, water and sewerage infrastructure and street lighting. Detailed Local Area Plans (LAPs) have been prepared for these settlements – five in the north and five in the south of Thimphu. A moratorium on new housing construction was imposed by RGOB in 2002 until demarcations of land plots are finalized and agreed. However, consultations with landowners have progressed slowly as the legal framework and procedures are elaborated, and staff skills developed through experience. Agreements on the layout of LAP and land pooling arrangements have been reached in some areas, and RGOB approached IDA and ADB to request financing for infrastructure development - ADB in the south of Thimphu and IDA in the north of the city. An ADB loan was approved in December 2006.

1.5 The experience of LAPs illustrates the need to develop new approaches, institutions and capacities for urban management in Bhutan. The housing construction freeze and initial plans of providing high-standard public infrastructure services are consistent with the government-led development approach which has yielded Bhutan's rapid social as well as economic advances. Rapid urban growth, however, is likely to require sizeable investments and management capacities that cannot be met solely by government. Land pooling is a significant innovation to share the cost of urban development with landowners, but needs to be refined for higher efficiency and flexibility. Further, the current urban management and finance systems require reorientation to enable the market and enhance efficiency and equity.

2. Objectives

2.1 The proposed project development objectives are to: (i) support Bhutan's municipal reform program to achieve a more decentralized and accountable urban local government system, starting in Thimphu and Phuentsholing; and (ii) improve infrastructure services in northern Thimphu where no formal services are currently available. The first objective supports RGOB's municipal reform agenda and helps implement Bhutan's new Local Government Act (2009) through technical assistance, policy support, training programs, and studies. The project aims to help establish an effective intergovernmental fiscal transfer system. The second objective addresses an urgent need for serviced urban land in rapidly growing Thimphu, given the already substantial and increasing migrant population settling in the peripheries of the city. The process of attaining these objectives would help develop models and capacity for broader urban management in Bhutan.

3. Rationale for Bank Involvement

3.1 IDA initiated its support to Bhutan's urban sector with the Bhutan Urban Development Project (1999-2006). This project helped develop urban water supply in ten small and medium-sized towns, including serviced sites in three towns. It helped strengthen local government project management capacities and instituted a cost recovery system for water supply. The Royal

Government has shown strong interest and appreciation for the Bank's policy advice provided through this project and, more recently, technical assistance to prepare the national urban strategy and Thimphu city development strategy.

Given the need to accommodate the rapidly increasing urban population and develop Bhutan's policies and institutions to facilitate and manage urban growth, the proposed project could make significant contribution to the equitable and sustainable expansion of urban services -- an essential element of the first pillar of the Bank's current Country Assistance Strategy (CAS) for Bhutan (2005). The project also contributes to private sector development, the second pillar of the CAS. Finally, continued Bank support for urban development in Bhutan will likely represent a major thematic area of the next CAS which is currently under preparation.

3.2 Given the ongoing democratization and decentralization process in the country, the Bank's involvement in this project will provide an excellent opportunity to assist RGOB in creating a more autonomous and accountable local government system through a series of policy support, technical assistance and institutional capacity building measures.

4. Description

4.1 The project is proposed as a specific investment loan with a technical assistance and an investment component, each designed to achieve the project development objectives. A summary of each component is described below:

Municipal Reform (US\$ 1.8m)

4.2 This component aims at strengthening the institutional systems and processes of the two city corporations in Thimphu (TCC) and Phuentsholing (PCC) to enable them to function effectively as transparent and accountable local governments which are capable of providing urban services in a sustainable manner. It will also support RGOB to undertake policy reforms to strengthen of municipal finances. Support for city-specific reform measures will be comprised of two broad areas, namely: (i) strengthening the own source revenues and revenue administration systems of TCC and PCC; and (ii) strengthening expenditure management systems and financial accountability within TCC and PCC. Support for policy reforms will enable RGOB to design and implement an inter-government fiscal transfer system to the cities based on sound, rational, predictable and transparent principles.

Thimphu Northern Area Development (US\$ 8.5 million)

4.3 RGOB/TCC has been planning to develop the Northern areas, consisting of five Local Area Plans (LAPs), through a land-pooling approach. RGOB prepared the Bhutan Land-Pooling Rules, and the Cabinet approved the Rules on March 17, 2009. As per the new rules, at least two thirds of landowners have to support land pooling in order for development plans to proceed. This component will focus on two LAP areas in northern Thimphu (Dechencholing and Langjophakha) where preparations for land-pooling are most advanced. The project will finance development of basic infrastructure systems in these areas, including roads, storm-water drainage, water supply, sewerage, and street

lighting. This component will also support an increase in the number of low-income housing units in these areas.

Capacity Building (US\$ 0.7 million)

4.4 This component aims at significant upgrading of the capacities of each city corporation and MOWHS in various aspects of their internal work processes and service delivery to citizens through the training of staff and the provision of equipment. As populations in both cities are projected to grow over the coming years, the requirement for increased and improved urban services delivery will also expand rapidly. The two city corporations, as well as the DUDES/PPD of MOWHS, will have to cater to the urban population with an array of services which will call for strengthening of both the quantity and quality of their staff.

5. Financing

Source:

(\$m.)

INTERNATIONAL DEVELOPMENT ASSOCIATION

11

Total

11

6. Implementation

6.1 There will be a high-level steering committee overseeing project implementation, consisting of representatives from MOWHS, MOF, TCC, and PCC. The committee will meet bi-monthly to review implementation progress and discuss key implementation issues.

6.2 All physical works under the project will be implemented by TCC's Engineering Division in close coordination with its Planning Division. TCC has recently strengthened the Engineering Division by increasing the number of technical staff, such as water engineers, and designated them for this project on a full-time basis. This group which is responsible for procurement, technical designs, construction supervision, contract management, etc., is led by a senior engineer who will serve as a de-facto project director and oversee four engineers below him/her. DUDES will provide technical backstopping for TCC. The project will also finance TA consultancies to TCC to assist them in implementing this component. The Executive Secretary of TCC will have the ultimate responsibility for any physical aspects of the project in the city.

6.3 TCC's Planning Division, headed by the Chief Town Planner, has already designated one urban planner each for the two project areas (Dechencholing and Langjopakha) and also newly recruited two social development specialists. Working closely with the Engineering Division, the Planning Division will ensure that land pooling schemes are implemented in a smooth manner. Their responsibilities include: continuous community consultation, information dissemination, timely execution of safeguard actions specified in the resettlement action plans, and any planning adjustments required during implementation. The Division will also serve as a secretariat for a Grievance Redress Cell which will consist of council members, a legal officer, local representatives, a concerned urban planner, and other stakeholders.

6.4 The policy-related TAs will be procured by the Policy and Planning Division (PPD) of MOWHS, and procured services/goods will be provided to TCC and PCC. TCC and PCC have recently recruited a Chief Administrative Officer heading its Finance and Administrative Division who will play a key role in implementing TA activities under this component. Most in-country training under the capacity building component will be administered as per an MOU between the Ministry and the College of Science and Technology (CST), Royal University of Bhutan.

7. Sustainability

7.1 The key sustainability issue is TCC's capacity to successfully operate and maintain new infrastructure assets to be created under the project. TCC has already demonstrated its potential by successfully managing water and sewerage systems serving the core areas with an adequate level of cost recovery. The project will further strengthen TCC's capacity through technical assistance and training programs to upgrade skills for urban management and infrastructure operations and also help generate increased levels of local revenue through more efficient collection of user charges and property taxes.

8. Lessons Learned from Past Operations in the Country/Sector

8.1 The following key lessons were identified under the first Bhutan Urban Development Project (BUDP1), as described in the project's Implementation Completion Report (ICR). These lessons have been taken into account in the design of the Second Bhutan Urban Development Project (BUDP2).

8.2 *A project should have a sufficient level of readiness for implementation before its approval.* BUDP1 suffered from the lack of implementation readiness, and most of the project preparation activities started after the project approval, leading to the very low disbursement amount for the first few years and delayed implementation. The physical component of BUDP2 will be implemented in phases (starting with Dechencholing) and the engineering documents for the first year investments are ready.

8.3 *There is a trade-off between the number of project towns and the level of effective engagement with local governments, especially in Bhutan.* BUDP1 covered ten towns spread across the country, making it difficult for the Bank and the Central Government to effectively monitor and supervise project activities, and further exacerbated by Bhutan's rugged terrain. This led to rather superficial engagement with each dzongkhag (district) administration participating in the project. Creating lasting capacity in local governments requires more capacity building efforts and deeper engagement. BUDP2 will target the country's two largest cities, Thimphu and Phuentsholing, with physical investments confined to northern areas of Thimphu.

8.4 *Clear implementation arrangements and identification of capacity constraints are paramount* in a project, especially with decentralized implementation responsibilities. Under BUDP1, insufficient attention was paid to the capacity available within dzongkhag administrations to implement the project. This led to knowledge and capacity gaps unfilled by needed technical assistance and training. BUDP2 will ensure that city governments will have an adequate level of counterpart staff assisted by tailored technical assistance and training programs to support smooth implementation and build capacities.

8.5 *Land development components require careful preparation.* BUDP1 included a few schemes of land development called *sites and services*, which were very challenging due to the high cost of acquiring land and due to difficulties in allotting developed plots to beneficiaries in an equitable and transparent manner. BUDP2 will adopt a land-pooling approach where land owners remain in-situ after contributing a certain percentage of land for infrastructure and public spaces.

9. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[X]	[]
Natural Habitats (OP/BP 4.04)	[]	[X]
Pest Management (OP 4.09)	[]	[X]
Cultural Property (OPN 11.03 , being revised as OP 4.11)	[]	[X]
Involuntary Resettlement (OP/BP 4.12)	[X]	[]
Indigenous Peoples (OD 4.20 , being revised as OP 4.10)	[]	[X]
Forests (OP/BP 4.36)	[]	[X]
Safety of Dams (OP/BP 4.37)	[]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[]	[X]

10. List of Factual Technical Documents

Environmental Assessment Report
 Social Assessment Report including Resettlement Action Plan
 Bhutan National Urbanization Strategy 2008
 Thimphu City Development Strategy 2008
 Bhutan Land Pooling Rules 2009
 Technical Design Documents

11. Contact point

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* *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*

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