PUBLIC DEBT MANAGEMENT POLICY 2023

"Enabling Sustainable Socioeconomic Development"

ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
JUNE 2023

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Ministry of Finance
Royal Government of Bhutan

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Foreword

As Bhutan prepares to graduate from the list of Least Developed Countries (LDCs), measures have been taken to ensure a smooth transition, including reinforcing macroeconomic stability and sustaining economic growth. However, limited access to low-cost finance and the hardening of concessionary lending terms from multilateral agencies are expected with the increase in GDP per capita. This, coupled with dwindling grant resources, means an increase in external borrowings.

To address this, the Ministry of Finance has developed the Public Debt Management Policy 2023, sunsetting the Public Debt Policy 2016. The new policy includes public sector debt classification along with the domestic debt management, a framework on government guarantees and on-lending to State Enterprises (SEs), revised public debt thresholds, and a debt monitoring and reporting framework. It is hoped that this policy will enable the government to proactively guide its investment plans and ensure prudent financing decisions are made to maintain public debt at a sustainable level.

The Public Debt Management Policy 2023 was approved in the 145th Lhengye Zhungtshog session held on June 07, 2023.

Tashi Delek

(NAMGAY TSHERING)

List of Abbreviations

ADB	Asian Development Bank
AFS	Annual Financial Statement
BoP	Balance of Payments
DCDMD	Development Coordination and Debt Management Division
DGPC	Druk Green Power Corporation
DHI	Druk Holding and Investment Limited
DMDF	Department of Macro-Fiscal and Development Finance
DOE	Department of Energy
DSA	Debt Sustainability Analysis
DTA	Department of Treasury and Accounts
ECB	External Commercial Borrowing
ESG	Environmental, Social, and Governance
FRR	Financial Rules and Regulations
GoI	Government of India
GNH	Gross National Happiness
ICGD	Investment and Corporate Governance Division
IFAD	International Fund for Agriculture Development
IMF	International Monetary Fund
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MoENR	Ministry of Energy and Natural Resources
MoF	Ministry of Finance
MTDS	Medium Term Debt Management Strategy
MoU	Memorandum of Understanding
NSB	National Statistical Bureau
PEFA	Public Expenditure and Financial Accountability
PFA	Public Finance Act
PPCM	Policy and Planning Committee Meeting
RAA	Royal Audit Authority
RGoB	Royal Government of Bhutan
RMA	Royal Monetary Authority
SE	State Enterprise
T-Bills	Treasury Bills
T-Bonds	Treasury Bonds
WB	World Bank

1. Background

Bhutan achieved significant socioeconomic progress since the implementation of its first five-year plan in 1961. Public finance and investments played a critical role in overall growth and development of the nation. Bhutan's public financial management is guided by the principles of fiscal prudence, sustainability, and equity, as well as the goal of promoting Gross National Happiness (GNH).

Fiscal discipline is a key aspect of Bhutan's public finance management. The country has implemented the 2016 Public Debt Policy, which includes a fiscal responsibility and debt management policy as well as a medium-term budget framework. These tools help to ensure that government spending is sustainable and transparent and that the country's debt levels remain manageable. Although Bhutan's debt-to-GDP ratio is relatively high, its unique dynamic of debt structure mitigates and complements prudent fiscal policies.

Transparency and accountability are also important elements of Bhutan's public debt management. The country publishes its budget documents and conducts audits to ensure that public funds are used appropriately. Bhutan has also established a Public Expenditure and Financial Accountability (PEFA) framework to assess the quality of its public financial management.

Overall, Bhutan's Public Debt Management Policy is guided by a holistic approach to development, which prioritizes the well-being of its citizens and the sustainability of its resources. It is designed to support Bhutan’s economic growth and development, while also safeguarding its financial stability and long-term sustainability to avoid the risk of debt distress and ensure that the servicing of public debt will not place an undue burden on future generations. Furthermore, it sets forth certain debt management objectives for the Country and establishes overall parameters for pursuing and administering the Country’s debt.

2. Scope

This Public Debt Management Policy shall cover all public sector debt including external and domestic debt of the central government, State Enterprises, the Royal Monetary Authority (RMA), and contingent liabilities (government guarantees). To meet the financing needs, the government may resort to public borrowings from both external and domestic sources, including government guarantees, on-lending, and innovative debt financing mechanisms.

3. Objective of the Public Debt Management Policy

The objective of the Policy is to maintain the public debt at a sustainable level through prudent and transparent financing decision-making. The country shall consider the overall impact of the current and future debt burden of financing when borrowings are pursued while ensuring accountability for the fiscal health of the country, including management and transparency of the country's financing program.

The purpose of this Policy is to assist the country in pursuit of the following objectives:

i. Minimize debt servicing and issuance costs, subject to prudent risk levels.

ii. Minimize refinancing and market-related risks through an appropriate currency composition, interest rate, and maturity structure, and an optimal blend of financing from both domestic and external sources, as outlined in the Medium-term Debt Management Strategy (MTDS).

iii. Maintain access to concessional and cost-effective borrowing.

iv. Pursue commercial borrowings only for self-liquidating projects.

v. Full and timely servicing of debt.

vi. Foster reliable and robust domestic capital market development.

vii. Maintain full and complete financial disclosure and reporting.

viii. Diversify external financing sources and explore options linked to Environment, Social, and Governance (ESG) borrowing, given the availability of climate financing and the increasing importance of the ESG agenda.

4. Legal Framework

The Policy is based on the Constitution of the Kingdom of Bhutan, the Public Finance Act (PFA) of Bhutan 2007, the Royal Audit Act of Bhutan 2018 and the Royal Monetary Authority of Bhutan Act (RMA Act) 2010, and amendments thereof (see Annex I: Legal Framework).

5. Public Sector Debt Classification

Based on financing sources and borrower's category, the public sector debt is classified as follows:

5.1 Central Government Debt: The Central government debt refers to the amount of money that the government raises from the public including individuals, corporations, and other countries in the form of loan[1] for financing fiscal deficit. The central government debt comprises external and domestic debt as follows:

5.1.1 External Debt: External debt refers to the amount of money raised by the government from foreign creditors, such as other countries, international organizations, and private lenders under foreign law.

Guiding principles for external borrowing. The Government shall adhere to the following guiding principles while sourcing external financing:

i. External debt financing should only be used to meet the financing requirements of the government's development priorities and be considered only after all possibilities of obtaining funds in the form of grants are exhausted.

ii. Concessional debt financing from external sources should be prioritized over other financing alternatives.

iii. Borrowing at commercial rates should only be considered for investment in financially viable projects with a good economic rate of return.

5.1.2 Domestic Debt: Domestic debt refers amount of money raised by the government from its own citizens or institutions within its borders and under the local legislation through issuance of bonds, treasury bills, or other forms of debt securities.

Guiding principles for domestic borrowing: The government shall consider the following principles while borrowing from the domestic market:

[1] See PFA Section 126

i. The primary approach for obtaining domestic funding will be through market-oriented strategies like competitive auctions and syndication.

ii. Clear regulations and guidelines will be established for issuing government securities to the public. These rules should cover auction pricing, mechanisms, transparency, investor relationships, market information, and communication strategies, as well as public subscriptions, eligibility requirements, bid submissions, allotment mechanisms, and auction results.

iii. Bond issuance must have a separate Offer Document to complement the Rules and Regulations.

iv. The Ministry of Finance (MoF) shall publish an annual borrowing calendar for Treasury Bills (T-Bills) and Treasury Bonds (T-Bonds), covering the following quarter, which will be based on its annual borrowing plan. The calendar will be made available at the start of each fiscal year and may be revised to reflect adjustments in domestic financing requirements and market feedback.

v. The government may consult the RMA during the preparation of its annual domestic borrowing plan to ensure no overlapping tenures with RMA bills and to avoid hindering private sector borrowing.

vi. All tender notices will be published in newspapers and on the website of MoF and RMA, indicating all terms and conditions, including the desired amount by the government.

5.2 State Enterprise Debt: State Enterprise Debt refers to amount of money raised by and for the State Enterprises to finance their operations and investment requirements. The government may borrow and then lend to the state enterprise through the on-lending section of this Policy.

Guiding principles for State Enterprise borrowing: The state enterprise borrowings should adhere to the following principles.

i. State enterprises shall inform and seek written consent of the Ministry of Finance in keeping with PFA before incurring any debt or liability, actual or contingent.

ii. State Enterprises shall consider borrowings after exhausting all other available financing options.

iii. Debt raised by a state enterprise and its subsidiaries shall be considered as a contingent liability of the government and should be included in the country's total public sector debt

iv. State enterprises shall be subject to the External Commercial Borrowing (ECB) Guidelines 2010 (and amendment thereof).

5.3 Royal Monetary Authority Debt: The RMA debt refers to debt instruments and other short-term liabilities such as SWAP/Overdraft/credit line facilities availed by RMA to implement and regulate monetary policy including reserve management. The RMA should adhere to the following principles while issuing debt instruments.

i. Debt contracted by the RMA shall form part of the country's total public debt.

ii. The issuance of debt securities and other short-term liabilities such as SWAP/Overdraft/credit line facilities by RMA must be well-coordinated with MoF to ensure proper separation of fiscal and monetary policy objectives and to prevent market fragmentation.

iii. The RMA shall prioritize the development of the repurchase agreement (repo) market in the financial sector to promote the growth of securities markets.

6. Government Guarantee

The government guarantee is a promise or commitment made by the Government to take responsibilities for the financial obligation of a borrowers in the event of default on their loan or other financial obligations. The objective of government guarantees is to encourage economic activities that might not otherwise occur due to risk or uncertainty in the market.

Guiding Principles for Government Guarantee. The Government shall adhere to the following principles while considering Government Guarantees.

i. The Minister of Finance shall issue a government guarantee to a budgetary body, a state enterprise, or organization as appropriate after seeking concurrence of the Lhengye Zhungtshog.

ii. The Government Guarantee should be transparent and subject to oversight to ensure effective and efficient use of the guarantee.

iii. The Government guarantee should be designed to be cost effective minimizing the cost to tax payers while maximizing their impact.

iv. Government guarantee should be designed to promote long-term economic growth and development rather than providing short-term relief.

v. All requests for government guarantee shall be accompanied by a letter of intent to the MoF who shall review the request before submitting it to the Cabinet for approval. The DMDF under the MoF shall record, monitor and publish the guarantees' stock and currency.

vi. The eligibility, conditions, threshold and process for Government Guarantee shall be based on the Government Guarantee guidelines prescribed by MoF from time to time.

7. On-lending

In line with PFA 2007 (and amendments thereof), the government may on-lend to state enterprises for socially beneficial projects that support its development priorities. On-lending refers to government borrowing funds from external/domestic sources and relending to another borrower, typically domestic entity such as state enterprise or local government to provide financing with the objective to minimize the cost of borrowing and easy access to financing.

Guiding principles of on-lending. The Government shall adhere to the following principles while considering on-lending to other entities.

i. On-lending shall be aligned with national development priorities and objectives.

ii. The process of on-lending should be transparent and subject to oversight to ensure that the funds are being used for their intended purpose and to minimize the risk of corruption.

iii. It should be designed to promote sustainable economic growth and development rather than providing short-term relief.

iv. On-lending should be designed to be cost effective minimizing cost to taxpayers while maximizing impact.

v. The government shall ensure that on-lending does not unfairly advantage private entities over State Enterprises.

vi. The eligibility, conditions, threshold and process for Government On-lending shall be based on the On-lending guidelines prescribed by MoF from time to time.

8. Debt Threshold

To ensure fiscal sustainability, maintaining economic stability, preserving creditworthiness, promoting intergenerational equity and providing policy flexibility, the Government shall adhere to the following debt threshold.

I. **Threshold for Central Government Debt**

   i. Total Central Government debt (External & Domestic) should not exceed 55% of GDP at any given year.
   ii. The total annual debt service (through budget) shall not exceed Thirty-Five percent (35%) of the total annual revenue.
   iii. Sovereign guarantee issuances shall not exceed 10% of the country's GDP at any given year.

II. Threshold for Hydro Debt

   i. While there is no limit to hydro debt, the debt service coverage ratio for hydropower debt shall be above 1.2.
   ii. In any given year, the ratio of hydropower debt service to hydropower export revenue shall be maintained within fifty percent (50%).

III. Exception to Debt Threshold.

   i. The Government may exceed the prescribed debt threshold during economic crises. During such times, the government shall declare such emergencies through official channel and inform the next parliament sitting of any such circumstances along with plans to stabilize debt levels and servicing to meet the required thresholds.

9. Monitoring and Reporting

9.1 Monitoring: The responsibility of monitoring the loan disbursements and repayments for on-lent and guarantees thereof lie with implementing and executing agencies and the Ministry of Finance.

The DMDF under the MoF shall routinely monitor all the guarantees and on-lent loans to ensure the following:

i. The beneficiary of the guarantee and on-lending are servicing their debt on time;
ii. Compliance with the signed agreement, in particular the guaranteed funds and on-lent funds are used as intended;
iii. The beneficiary (borrower) submits on quarterly basis - (i) data on disbursements and repayments due; and (ii) carry out reconciliation of debt data between two agencies;
iv. Submit construction progress report of projects semi-annually if any;
v. Properly identify and mitigate the risks of payment defaults by both the parties of guaranteed party/On-lent beneficiary;
vi. Timely payment of guaranteed and on-lent fee, if any.
vii. Timely recoveries are made in case of default; and
viii. The guarantee beneficiary informs well in advance of any foreseen difficulties in making debt servicing to the DMDF.

9.2 Annual Debt Sustainability Analysis (DSA): Maintaining public debt sustainability is crucial for the government's fiscal policy. The DMDF shall annually prepare and publish a DSA report, assessing public sector debt, including guaranteed and non-guaranteed debt of non-financial state enterprises under the MoF and DHI, with a cutoff-point of end-June of the previous fiscal year. The final report shall be uploaded on MoF website.

9.3 Annual Medium-term Debt Management Strategy (MTDS): As part of the National Budget, an annual MTDS will be developed and published to achieve the government's debt management goals and financing strategies. The MTDS shall capture the government's preferences for cost-risk trade-offs and focus on managing the risk exposure embedded in the debt portfolio. The MTDS shall be approved through the Policy and Planning Committee Meeting (PPCM) of the MoF and made publicly available on the MoF website.

9.4 Quarterly Public Debt Situation Reports

i. The DMDF under MoF shall publish a quarterly Public Debt Situation Report that is comprehensive and includes information on both stock and flow of public debt. The report shall be made available on the MoF website within one month after the end of the quarter. The report must include details on the composition of debt, debt servicing, redemption profiles, explicit contingent liabilities, and relevant cost and risk indicators. Also, the MoF must publish the Annual Financial Statement (AFS) and National Budget Report including the information on both the on-lending and guarantees issued in that particular financial year including the overall stock, currency denomination and sector supported.
ii. The RMA shall publish a monthly and quarterly statistical bulletin on its website that provides information on total external debt, including short-term and private

external debt, and capitalized interest on hydropower loans. The quarterly bulletin must also include T-Bills outstanding.

10. Policy Interpretation

In the event of conflict of interpretation of any part of this policy, the MoF shall, on behalf of the RGoB, be the final and binding authority.

11. Policy review and amendment

The RGoB will review and amend the policy as deemed appropriate to remain relevant to the emerging circumstances. The policy will come into force from 31st March 2023.

Annex I: Legal Framework

The Public Debt Management Policy is governed by the Constitution of the Kingdom of Bhutan 2008, the PFA 2007, the Audit Act of Bhutan 2018, and the Royal Monetary Authority Act 2010, and amendments thereof. The specific legal provisions governing the Policy are provided below.

Constitution, Article 14 (4): "The Government, in the public interest, may raise loans, make grants or guarantee loans in accordance with the law."

Article 14 (5): "The Government shall exercise proper management of the monetary system and public finance. It shall ensure that the servicing of public debt will not place an undue burden on future generations."

Article 14 (7): "A minimum foreign currency reserve that is adequate to meet the cost of not less than one year's essential import must be maintained."

The PFA grants the Minister of Finance authority to approve borrowings, issue public securities, lend money, and issue guarantees subject to Cabinet approval. The Minister of Finance is solely vested with the authority to contract debt, with powers that may be delegated to negotiate, contract, and sign the loan agreement or loan guarantee in writing via an Authorization Order, on a loan-by-loan basis to either the Secretary of the MoF, Ambassador or a high-ranking civil servant. For domestic debt, a Memorandum of Understanding exists between the MoF and the RMA for the issuance of T-Bills, used for cash management purposes.

The PFA requires that all foreign grants and loan proceeds are deposited with the MoF, which is responsible for accounting for all the activities financed. All grants, borrowings, and recoveries of on-lent funds are to be deposited in the Government Consolidated Account (GCA), which serves as the Treasury Single Account to the Government. The MoF is also required to prepare an AFS under Article 67 of the PFA, which includes a statement of the amount of public debt outstanding, amount guaranteed, and amount on-lent at the end of the financial year. The AFS is to be audited by the Auditor General and submitted to Parliament.

PFA, Chapter II, Section 7 (d): "The level of public debt shall be contained such that it will not create undue burden on future generations and threaten national solvency."

PFA, Chapter III, Section 15 (a) "Approval of borrowings and issuance of public securities subject to concurrence of the Lhengye Zhungtshog."

PFA, Chapter VII, Sections 124 to 128 "Loans may be raised by the Government only in accordance with the provisions of this Act. The Minister of Finance may raise a loan from any person, organization, or Government, either within or outside Bhutan. The Minister of Finance may borrow money for the following purposes only: (a) to finance budget deficits; (b) to refinance maturing debt or a loan paid before the redemption date; (c) to maintain credit balances in the bank accounts; (c1) on-lending to state enterprises and other legal entities; (d) or any other purposes approved by the Lhengye Zhungtshog. The authority of the Minister of Finance to raise loans under Section 125 shall include the authority to borrow money by way of the issue of public securities such as bills, bonds or commercial paper. For the purpose of this Act, the raising of a loan shall not include the purchase of goods or services or the obtaining of an advance by the Government through the use of a credit card or by a supplier providing credit for the purchase of goods or services."

PFA, Chapter VII, Sections 132 to 134 "The Minister of Finance may give a guarantee, indemnity, or security upon such terms and conditions as may be appropriate, in respect of the performance of any obligation by a budgetary body, a state enterprise, or organization. Any money paid by the Minister of Finance pursuant to any guarantee, indemnity, or security given under this Section or any other Act shall constitute a debt due to the Government from the organization in respect of whom the guarantee, indemnity, or security was given. Subject to the terms of the instrument authorizing the guarantee, indemnity or security, the debt as specified in Section 133 shall be recovered over such period of time, and on such terms and conditions, as the Ministry of Finance specifies."

Royal Audit Act of Bhutan 2018, Section 77: "Conduct the audit of aid, grants, loans, public debt, reserves, revolving funds, trust funds, welfare funds and specific purpose funds established by public institutions."

Annex II: Disclosure and Independent Audit

The Royal Audit Authority shall conduct annual financial and compliance audits of all loan/grant-funded projects/programs and share a copy of report with the MoF and implementing agencies.

The Department of Treasury and Accounts (DTA) shall prepare the Annual Financial Statement (AFS) in accordance with the PFA 2007, Article 67, and Financial Rules & Regulations (FRR) 2019. The AFS must include detailed reports by the Department of Treasury and Accounts (DTA) and Department of Planning, Budgeting and Performance on deviations from original and revised budgets. Similarly, the DMDF has to includes on the central government debt and grants received, as well as a breakdown of loans by creditor, debt servicing payments, domestic borrowing developments, on-lending activities, guarantees, and outstanding of hydropower debt.

The MoF must ensure transparent and timely dissemination of public debt statistics to the public and beyond through regular audits of public debt management and accurate disclosure of relevant information as follows:

Annual publication of MTDS and DSA Reports on the MoF’s website.

Submission of annual public debt report and borrowing plan to the parliament as part of the National Budget Report in line with the provision of the PFA.

Disclosure of all required documents and information related to aid/grants and public debt to the RAA to conduct its periodic performance audit.

Annex III: Institutional Arrangements

a. Ministry of Finance (MoF)

The Ministry of Finance is responsible for resource mobilization, including external assistance, and incorporating these funds into the budgeting, reporting, and accountability process under Section 23(c) of the PFA 2007. The MoF manages external resources in the form of borrowings and grants from multilateral financial institutions such as Asian Development Bank (ADB)/ World Bank (WB)/ International Fund for Agriculture Development (IFAD) and bilateral arrangements. Additionally, the MoF oversees the management of public guarantees issued by the government and on-lending to state-owned enterprises.

The MoF holds all grants and debt management functions and responsibilities. However, the Ministry of Energy and Natural Resources (MoENR) is in charge of signing all Government of India (GoI) hydropower loan agreements.

b. Department of Macro-Fiscal and Development Finance (DMDF)

The DMDF, as the nodal agency for both loans and grants (excluding GoI hydropower loans), is under the purview of the MoF. The DMDF will serve as the primary secretariat for implementing this policy and mobilizing resources. In order to ensure effective, consistent, and coordinated implementation, the DMDF will oversee all aspects of grants, public debt, innovative financing, and investment while maintaining close relationships with relevant domestic agencies and foreign development partners. The ICGD is responsible for loan guarantees.

c. Ministry of Energy and Natural Resources (MoENR)

Hydropower loans dynamics are treated differently in Bhutan. These loans, which are taken for the hydropower sector under an agreement between the GoI and the RGoB, are disbursed directly by the GoI to the project authority, bypassing the government budget. The Empowered Group, formed under an accelerated hydropower agreement between the two countries, discusses the terms of these loans. The Department of Energy (DoE) under the MoENR, in collaboration with the GoI, is responsible for negotiating and contracting these loans, while the MoF handles the Middle and Back Office functions based on information from project authorities. The projects become part of an Independent Project Authority after agreements and financial terms are established, and once commissioned, become part of the Druk Green Power Corporation (DGPC), which is managed by Druk Holdings and Investments Limited (DHI), a limited liability holding company.

d. Macroeconomic Framework Coordination Committee (MFCC)

The MFCC is headed by the Finance Secretary and includes senior members from the MoF, RMA, National Statistical Bureau (NSB), Department of Trade, Department of Tourism, and Department of Energy. Apart from its regular duties, the MFCC serves as the highest advisory body for the Public Debt Management Committee.

The MFCC advises and assists the RGoB on all aspects of Bhutan's public debt management and strategy. The technical inputs of the Macroeconomic Framework Coordination Technical Committee (MFCTC) and DMDF are used to make recommendations on public debt management to the Minister of Finance, who then presents them to the Lhengye Zhungtshog. The DMDF acts as the secretariat for both the MFCC and MFCTC.

e. Macroeconomic Framework Coordination Technical Committee (MFCTC)

The MFCTC is composed of technical staff from the same institution as MFCC. They are primarily responsible for monitoring macroeconomic variables, providing forecasts, and making recommendations to MFCC, which evaluates and approves the resulting resource gap or budget deficit. DCDMD provides loan and grant forecasting to the MFCTC working group and offers necessary technical support to enable impartial advice to the government. DMDF coordinates with MFCTC in the following areas:

- Providing technical support for periodic DSA and risk assessments
- Reviewing and evaluating all major project loan proposals, including the issuance of government guarantees to finance such projects
- Developing an efficient & robust domestic capital market.

f. Royal Monetary Authority (RMA)

The RMA Act designates RMA as the Government's banker and fiscal agent, responsible for managing government funds and issuing T-Bills for both monetary policy and government cash shortfall purposes. After using RMA bills for monetary policy until 2009, T-Bills were used instead, and a Memorandum of Understanding (MoU) was signed in November 2009, delegating to the RMA the decision-making authority for T-Bills issuance regarding amount, tenor, modalities, and timing.

The TBMC was established as a coordinating mechanism between RMA, MoF, and other relevant entities, for better coordination and exchange of information. It convenes regularly, but also at short notice when needed to address cash shortages. In such meetings, RMA shares liquidity information and supports the coordination of monetary policy and debt management operations.